The Journal of Social, Political and Economic Studies

Winter, 2001 Vol. 26, No. 1

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The Journal of Social, Political and Economic Studies is a refereed journal published quarterly by the Council for Social and Economic Studies. Subscriptions, manuscripts for submission to the editorial board, and all correspondence should be addressed to:

The General Editor,
P.O. Box 34070, N.W.
Washington D.C., 20043, U.S.A.

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Formerly known as *The Journal of Social and Political Affairs*, the subscription rate is $89.00 per annum for libraries and institutions, $38.50 p.a. for faculty members, students and other private individuals. Reduced three-year subscriptions are available at a cost of $220.00 for libraries and $110.00 for individuals. For mailing addresses outside the USA please add $12.00 per annum. Mastercard/Visa accepted.

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ISSN 0193-5941

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The Journal of SOCIAL, POLITICAL AND ECONOMIC STUDIES

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Spring, 2001 Vol. 26, No. 1

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The Ballistic Missile Threat: Defense and Technology

James H. Hughes
Englewood, Colorado

The United States is at a crossroads. It has defined the ballistic missile threat in terms of a rogue nation, principally North Korea, which demonstrated on August 31, 1998, the ability to launch a three-stage ballistic missile capable of attacking the United States. But the ballistic missile threat has grown rapidly, going far beyond a threat from a single rogue nation. China's buildup of short, intermediate, and long-range ballistic missiles, and the proliferation of ballistic missiles to countries such as Iran, Syria, Libya, and Pakistan (the threat of war between Pakistan and India, with its broad repercussions; and China's threat to Northeastern India) have multiplied the ballistic missile threat.[1] In this article, the author will discuss strategies and technologies of defense against these threats.

Key Words: Ballistic missiles, defenses to missiles, technologies of missile defense, missile proliferation, North Korea, China, Pakistan, Brilliant Pebbles, Brilliant Eyes, Space-Based Lasers, boost phase interception.

The ballistic missile threat has compounded. Countries such as Russia, China, and North Korea, involved in the proliferation of ballistic missiles, are forming strategic alliances. Russia and China have a strategic alliance, including the transfer of Russian SS-18 ballistic missile technology to China.[2] North Korean leader Kim Jong-Il has visited China, and has received visits from the PLA.[3] Russia and Iran

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[1] IRAN: Bill Gertz, "Inside the Ring: Shahab-3 test set," January 12, 2001. SYRIA: "Syria launches first Scud D missile," *World Tribune*, September 26, 2000. LIBYA: Con Coughlin, "Missiles deal puts Israel in Gaddafi sights," *Electronic Telegraph*, September 24, 2000. PAKISTAN/INDIA: Aamir Shah, United Press International, "Pakistan sends nuclear warning to India," September 13, 2000. Judith Miller and James Risen, "A Nuclear War Feared Possible Over Kashmir," *The New York Times*, August 8, 2000. CHINA/INDIA: Dinesh Kumar, "A Chinese road into India that New Delhi doesn't see," *The Times of India*, November 20, 2000. Luke Harding, "The forgotten flashpoint between nuclear powers," *The Guardian*, October 16, 2000.

[2] "Moscow pact to defy US shield," *Hong Kong iMail*, January 15, 2001. John Pomfret, "Beijing And Moscow To Sign Pact," *The Washington Post*, January 13, 2001.

[3] Joe McDonald, Associated Press, "N Korea Leader on Secret China Visit," January 16, 2001.

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have signed a formal military and security partnership.[4] China and Iraq have formed a strategic alliance, profoundly altering the b-alance of power in the Middle East and Southwest Asia.[5] With China and Iraq as allies, China's recent diplomatic initiatives with Syria and Iran, sending Vice President Hu Jintao, must be evaluated in a new light.[6] China's ballistic missile assistance to Pakistan, and North Korea's ballistic missile sales to Syria and Libya compound the international implications.[7]

All of this means that a ballistic missile threat to the United States defined by a single rogue nation such as North Korea is outdated. The proliferation of ballistic missiles and alliances has increased the likelihood that a missile launched by one country will be connected to a missile launch or act of aggression by another. The United States, instead of facing a single rogue nation missile threat, is likely to face multiple threats. Moreover, the ballistic missile threat is becoming increasingly mobile, compounding the difficulty of using air power to suppress ballistic missile launches. And although some will ask whye we should worry about missile attacks when weapons of mass destruction can be smuggled into a tragetted country, the fact remains that when hundreds of ballistic missiles are in place, a country which has no protection against missiles is open to blackmail since it has no other defense that the dubious threat of retaliation after the event, or "mutual assured destruction".

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[4] Giles Whittel, "US alarm at Russian arms sale to Iran," *The Times*, December 30, 2000. Molly Moore, "Russia and Iran Renew Military Partnership," *The Washington Post*, December 29, 2000.

[5] Ismail Emet, China's State Councilor and Ethnic Affairs Minister, made a visit to Iraq before the new year, during which a strategic partnership between Iraq and China was successfully forged. Since then China has been assisting Iraq in developing its air defense system, as rcently revealed when the U.S. was obliged to time its February attack on Iraqi installations which were "painting" allied aircraft over the no-fly zone in order to avoid the possibility of hitting Chinese workers engaged in upgrading those same installations. Hu's [Hu Jintao, Vice President of China] visit to Iran and Syria further highlights the direction of Beijing's latest foreign policy, which is to generate new cards to play with Washington by making alliances with Islamic countries. Clearly, the main purpose of this move is to restrain President George W. Bush's favorable skew toward Taiwan. Cao Chang-Ching, "China's moves to contain Taiwan," *Taipei Times*, January 15, 2001. Leon Barkho, Associated Press, "Chinese Power Station Built in Iraq," November 2, 2000.

[6] Associated Press International, "King Adbullah II, China's VP Meet," January 14, 2001.

[7] Coughlin, *op. cit.*

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And the potential for aggressive missile launches against the U.S. and other nations is real. We see China building the road-mobile DF-31 ICBM, the road-mobile DF-41 ICBM, and the submarine-launched JL-2. It has flight-tested the DF-31 ICBM four times in the past year and a half.[8] Iran has looked at launching ballistic missiles from a ship. The ballistic missile threat, moreover, can appear as an upper atmosphere nuclear burst which would create an enormous electromagnetic pulse that would shut down U.S. satellite communications.

The potential for this type of attack on U.S. satellites, using an electromagnetic pulse, was warned about in a recent study by a panel chaired by Donald Rumsfeld, now Secretary of Defense.[9] Rumsfeld also chaired a congressionally appointed commission on assessing the ballistic missile threat to the United States that released its warning in July 1998, noting how the United States could expect little or no warning of a ballistic missile attack.

The ballistic missile threat faced by the United States can appear unexpectedly from any quarter. The threat is global. The proliferation of ballistic missiles and international alliances has made the rogue nation ballistic missile threat obsolete. The United States must change its estimate of the ballistic missile threat. The new ballistic missile threat will affect the design, depth, and cost of its proposed ballistic missile defense.

Defense Measures

U.S. missile defense plans carried over from President Clinton's administration call for deploying 100 ground-based interceptors in Alaska. This defense was designed around the North Korean ballistic missile threat. It assumed North Korea's ability to develop decoys and countermeasures would be limited, and that its proposed X-band radar at Shemya Island and Kinetic Kill Vehicle infrared seekers would be sufficient to discriminate between decoys and actual missiles in a North Korean launch. In addition to these two methods for discriminating

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[8] Reuters, "China Tested Long-Range Missile Last Saturday," December 23, 2000. Bill Gertz, "Inside the Ring: China tests DF-31 again," December 22, 2000, and "Pentagon confirms China's missile test, Unannounced trial of DF-31 was conducted in the spring," *The Washington Times*, December 13, 2000.

[9] Andrea Stone, "'Space assets' face threat," *USA Today*. January 11, 2001, p. 1A, and "USA's dependence on satellites places nation at risk," p. 5A.

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warheads from decoys (X-band radar and infrared sensors), the United States plans to deploy a constellation of missile launch detection and tracking satellites called SBIRS-low (Space Based Infrared Sensors - low earth orbit).

Criticism of the proposed U.S. "National Missile Defense" (NMD) has been voiced on the ground that it may not be able to discriminate between warheads and decoys in a general-threat scenario, going beyond previous estimates of North Korean countermeasures and decoys. To its credit, the U.S. Ballistic Missile Defense Organization has take an active role in working out the problem of decoys and countermeasures, seeking to improve discrimination technology. Notwithstanding this criticism, correctly stated, it must be remembered that the U.S. NMD was designed to defend against a ballistic missile threat President Clinton defined narrowly.

The narrow design limitation placed on NMD by President Clinton differs markedly from other U.S. ballistic missile defense programs such as GPALS (Global Protection Against Limited Strikes) that were developed in the early 1990's under the first President Bush's administration. (GPALS evolved from the Strategic Defense Initiative (SDI) that President Reagan began on March 23, 1983.) In developing GPALS, the Strategic Defense Initiative Organization (SDIO) took a broad and robust viewpoint toward looking at the ballistic missile threat. As a result, it proposed a more flexible and robust defense than NMD.

GPALS was designed to defend against a) accidental ballistic missile launches; and b) limited ballistic missile strikes, which could be launched from any quarter of the globe. Compared to NMD, GPALS included North Korea's developing ballistic missile threat among other threats. President Clinton's NMD, designed simply to counter North Korea's threat, will provide modest or no capability against other threats. NMD is largely limited to ballistic missiles coming in over the North Pole from northeastern Asia. GPALS, in contrast, was a global defense against all ballistic missile threats.

With the end of the Cold War, GPALS's depth of defense - its ability to defend against large scale attacks - was designed to be limited. GPALS was expected to defend against the possibility of, for example, an accidental launch from a Russian nuclear submarine - a boatload of missiles -, but not from the whole Russian missile arsenal. Nonetheless, GPALS was expandable - capable of having its depth of defense increased. The key to GPALS's global coverage and expandability lay

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in the deployment of Brilliant Pebbles.

Brilliant Pebbles, a miniature space-based interceptor, would have provided a late boost phase and mid-course phase defense. They were intended to be autonomous in operation, with overrides, so that they could be survivable in a nuclear threat environment. Their small size (about six feet long, weighing around 100 pounds) would have made them difficult targets. Their autonomy in detecting a launch and performing an interception would have weakened countermeasures against their command and control. GPALS proposed deploying 1,000 Brilliant Pebbles to provide global coverage of limited strikes and accidental ballistic missile launches. A larger constellation would provide more depth, useful against larger threats.

Brilliant Pebbles deployed in space would also have the advantage of multiple opportunities for intercepting missiles, improving chances for interception:

> A constellation of 1,000 space-based interceptors would put five interceptors within the range needed to destroy a 5,500-mile-range missile in its boost phase. It would put 30-35 interceptors within range to demolish the same missile in its post-boost phase. Finally, it would put 125-135 interceptors to have three independent opportunities (shoot-look-shoot-look-shoot) within range to destroy the missile in its mid-course phase.[10]

NMD, in contrast, will provide only one or two opportunities.

Under GPALS, Brilliant Pebbles would have been aided in the tracking and discrimination of warheads from decoys by the Brilliant Eyes constellation of space-based infrared sensors. Under President Clinton, the Brilliant Eyes program turned into SMTS, then SBIRS-low, and never got done. (The companion to SBIRS-low, SBIRS-high, is a replacement for current DSP early- warning launch satellites, featuring upgraded missile detection and tracking capabilities.)

GPALS was also developing chemical Space-Based Lasers that would provide a boost phase interception capability. The advantages of Space-Based Lasers include the ability to intercept a ballistic missile earlier in its boost phase than Brilliant Pebbles, and the active

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[10] *Ibid.*, pp. 4, 36.

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discrimination of warheads and decoys during their mid-course phase, providing another avenue for discrimination beyond X-band radar and infrared sensors.

Boost phase interception is extremely advantageous for a ballistic missile defense. It eliminates the problems of decoys and other mid-course phase countermeasures. GPALS and SDI had other directed-energy weapons under development that also could have provided a boost phase defense, but these programs were terminated or reduced because of funding cutbacks. As a result, GPALS placed its emphasis on near- or nearer-term deployment technologies.

One of the key strengths of GPALS lay in its adoption of a multiple-layer defense. GPALS envisioned an initial U.S. ballistic missile defense of Brilliant Pebbles and ground-based interceptors strengthened by Space-Based Lasers. With its multiple-layer defense format, other ballistic missile defenses could be added as they were developed, such as Neutral Particle Beams. GPALS also envisioned the early deployment of theater missile defenses, reflecting the proliferation of short and intermediate range ballistic missiles, which was validated by the U.S. experience against Iraqi Scuds in the 1991 Persian Gulf War.

GPALS saw theater missile defenses as a way to protect U.S. forces and allies in overseas deployments in situations where short and intermediate range ballistic missiles would be encountered. It saw theater defenses as complementary to space-based defenses and ground-based interceptors based in the United States. It is worth noting that space-based defenses such as Brilliant Pebbles and Space-Based Lasers would have been capable of both theater and U.S. national missile defense.[11] GPALS initiated or supported theater missile defense programs such as the Thaad (Theater High Altitude Area Defense), PAC-3, Navy Theater and Area Wide (that gave Navy Aegis cruisers and destroyers a ballistic missile defense capability), and the AirBorne Laser.

The United States developed GPALS over a decade ago to counter the expected proliferation of ballistic missiles and threat of accidental ballistic missile launches. (The threat of an accidental launch by Russia came unexpectedly close in January 1995 when a Norwegian sounding rocket activated Boris Yeltsin's nuclear "football" for launching a

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[11] *Ibid.*, pp. 4, 36.

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ballistic missile strike.) Since then, United States failed to deploy GPALS not because of technology, but because it lacked the will and commitment to fund the program. In 1993, President Clinton not only cut ballistic missile defense programs, but limited the focus of U.S. ballistic missile defense programs to theater defenses. He cut space-based defenses, and research and development. Brilliant Pebbles was terminated, funding for Space Based Lasers was slashed.[12]

Policy Transition

The United States, having recently undergone a change in administration, stands at the threshold of deploying a strong and effective ballistic missile defense. Secretary of Defense Donald Rumsfeld said in his Senate confirmation hearings, "there is no question but that I think that we should deploy a missile defense system when it is technologically possible and effective." Rumsfeld also called the 1972 ABM Treaty "ancient history," recognizing the fact that the Cold War had ended and ballistic missiles have proliferated.[13]

This opportunity for the United States to build an effective ballistic missile defense may, however, be forfeited unless the United States realizes:

1. It is technologically possible today to build an effective ballistic missile defense. "*When* it is technologically possible" is not the question. The Strategic Defense Initiative performed numerous studies showing technological feasibility for an effective ballistic missile defense. SDI studies showed over and over how any technological issues could be resolved or overcome, given adequate program support - a commitment to build the defense and solve engineering problems.

2. GPALS provided an architecture for building an effective ballistic missile defense using space-based defenses such as Brilliant Pebbles and Space Based Lasers along with ground based and theater defenses. (Other space-based defenses could have also provided effective defenses but were left out because of GPALS's emphasis on defeating a limited ballistic missile threat - funding

[12] *Ibid.*, pp. 36, 46-47.
[13] Donald Rumsfeld, U.S. Senate Confirmation Hearings, January 2001.

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cuts reduced the scope of its program.) Key characterizations of GPALS were its global coverage, multiple layers, and boost phase interception, which could be achieved by deployment in space.

3. The development of technology requires commitment to work through engineering difficulties, testing, and evaluation. No technology is without its problems, especially in initial tests and demonstrations. Technology is a solution process, not a finished product. Testing and development go together. Test failures, as well as fixes and improvements, should be expected.[14]

4. Building an effective ballistic missile defense will cost money. While some designs and architectures will be more effective than others, a ballistic missile defense will require a bottom-line commitment to funding. The main reason the United States has not deployed a ballistic missile defense is that it has underfunded its ballistic missile defense programs.

5. Deliberate vulnerability to ballistic missile attack as in the 1972 ABM Treaty is foolhardy. Ballistic missiles have proliferated because of the lack of ballistic missile defense.

The key challenge the United States faces in leadership to build an effective ballistic missile defense is understanding how the Strategic Defense Initiative has already laid out the foundation of architecture and technology for building a highly effective ballistic missile defense. The United States needs leadership that can assert the value of prior ballistic missile defense studies and technological development.[15] While it will be important to update SDI studies for a new threat evaluation and for new technology, the basic architectures and technologies developed under SDI (later GPALS) remain sound, and can be affirmed.

The United States needs leadership that can point out the value of a GPALS type of defense using Brilliant Pebbles and Space Based

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[14] James H. Hughes, "Technological Leadership," *Journal of Social, Political and Economic Studies*, Volume 25, Number 3, Fall 2000, pp. 303-318.

[15] O' Dean Judd, "A Chronicle of Ballistic Missile Defense After1980" (Los Alamos National Laboratory), September 2000. Gregory H. Canavan, "Directed Energy Concepts for Strategic Defense," Los Alamos National Laboratory, June 1988. Robert Jastrow, *How to Make Nuclear Weapons Obsolete* (Boston: Little, Brown and Company, 1985), pp. 44-52.

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Lasers, and that such a defense would be effective even against numerous countermeasures. Navy Theater Wide can be accelerated by increasing funding.[16] Lack of resources, not technology, has constrained current U.S. ballistic missile defense programs.[17] Even the initial test problems of Thaad were largely due to quality control, not technology - experimental bugs for which testing is needed.

The United States needs to assert technological leadership, renew programs for building new types of defenses, and exploit promising technologies in directed-energy weapons and other areas. There is a rich potential in directed-energy weapons - free electron lasers, excimer lasers, and neutral and electron particle beams, for example - that can be developed into programs for new defenses. SDI has already performed research and development in these areas. The verdict is in that the technology is feasible. The United States needs to assert that the technology is feasible, and set about exploiting the technology for a ballistic missile defense.

Technology

Technology with its testing, fixes, and failures, is a process. The United States needs to distinguish between technological feasibility, and the task of converting feasibility into a weapons program. Basic science and technological feasibility have already been demonstrated for ballistic missile defense: the use of sophisticated decoys and countermeasures can be countered by good design and technology. What is at issue is the need to appreciate and exploit the technology already developed for a ballistic missile defense.

Underfunding of U.S. ballistic missile defense programs has created the impression of technological difficulty as quality control issues and the shortage of resources have plagued NMD and interceptor tests and Thaad. The United States needs to see that it has shortchanged its ballistic missile defense programs. Experimental processes are trial and error. Not every hardware test can be fully simulated by a computer program. Indeed, such simulation is, in a sense, not cutting-edge. The United States needs to remember that technology is not always bought off the shelf.

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[16] Ambassador Henry F. Cooper, "Deceptions on Navy Theater Wide Costs?," Strategic Issues Policy Brief, High Frontier, February 28, 2000. James H. Hughes, "Navy Upper Tier," *Space Energy and Transportation*, Volume 3, Number 1, 1998, pp.13-18.

[17] Cooper, Missile Defense Study Team, *op. cit.*, pp. 46-47.

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The United States would do well to exploit current technology, focusing on Brilliant Pebbles and Space-Based Lasers, continue developing new defenses such as neutral particle beams, and initiate new research and development. The United States would do well to continue its current NMD program to provide a defense of some type, which can be accommodated in a multiple-layer defense format, and can serve as a test element for battle management, command, and control.

Summary

The ballistic missile threat is growing, expanding with the proliferation of ballistic missiles and alliances of countries involved in proliferation. The United States has an unprecedented opportunity to build a highly effective ballistic missile defense by exploiting prior technological development and architectural work accomplished under GPALS and SDI. Brilliant Pebbles was fully approved as a Major Defense Acquisition Program in 1992. Space-Based Lasers can be deployed pending their final testing and engineering. Navy Theater Wide is constrained by funding. Research and development has been productive. Technological feasibility is not the issue.

But unless the United States changes its current ballistic missile defense programs to utilize the advantages of space-based defense and to renew the research and development of new technology, and unless it increases its commitment and funding for building a ballistic missile defense, treating it as a major acquisitions program, it will forfeit this opportunity, and remain vulnerable to the ballistic missile threat.

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A Relook at Ballistic Missile Defense

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The different views of Ballistic Missile Defense are examined to explain the lack of response to an ever-growing missile threat. The Clinton Administration, having declared the ABM treaty a cornerstone of its international security policy, attempted to work with the Russians to modify the Treaty. Because these efforts were unsuccessful, the Clinton administration only endorsed a development scheme and did not commit itself to the deployment of a National Missile Defense. Instead, it established a series of gates that must be passed before system deployment is possible. This paper advocates the creation of an NMD program with growth potential, recognizing that it could lead to withdrawal from the ABM Treaty. However, because the closeness of the 2000 Presidential election of 2000 it may prove difficult to get agreement for rapid major changes of the Treaty, or in the initial architecture of an NMD system. The authors recommend a course of action to take advantage of the additional time that will become available. The objective will be to ensure that the United States is well equipped to implement a deployment when the opportunity occurs.

Key Words: Ballistic Missile Defense, National Missile Defense, the missile threat, Europe and missile defense, the United States and missile defense, Chinese missile policy, Russian missile policy.

The new World Situation

The apparently intractable association of Missile Defense with the ABM Treaty continues to arouse controversy. While some view Ballistic Missile Defense (BMD) as an increasingly essential feature to provide added security,[1] others consider it to be divisive and the precursor of a new arms race.[2] Advocates of both themes have become ever more raucous in their efforts to promote one thesis or the other. Those in favor of BMD overstate the expected capabilities and underplay the time and cost to produce a defense. Those who oppose the acquisition

[1] *The Washington Post*, June 11, 2000, p. B3.
[2] G. Lewis, L. Gronlund, & D. Wright, "NMD: An Indefensible System", *Foreign Policy*, Winter 1999-2000, p.120.

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suggest it would be destabilizing and lead to the collapse of arms reduction agreements, while also claiming that the technology is inadequate to provide an effective defense, which would cost too much anyway.

Amongst all this rhetoric was refreshing to hear the views of someone with unrivaled experience at the highest levels, coupled with a well-deserved respect for speaking the truth plainly, however unpleasant that truth may be. Earlier this year, Margaret Thatcher noted "We should all be extremely concerned about attempts to whitewash unpleasant regimes like those in North Korea, Iraq, Iran, Syria and Libya. All these countries have promoted or practiced violence. The proliferation of weapons of mass destruction affords them new opportunities to threaten us and our allies".[3]

During her address, she made it clear that in her opinion a nuclear weapons-free world was an infantile fantasy, which was why it remains essential for America and it's allies to retain and update their nuclear deterrent capabilities as the ultimate guarantor of security. Because of this need, Lady Thatcher considered that the U.S. Senate did the whole world a service by not ratifying the Comprehensive Test Ban Treaty. The end of Cold War and the substantial increases in proliferation that have followed that end have substantially changed the risks of both attack and intimidation.

In pointing out the complete lack of intellectual consistency in left-of-center political parties, she noted that while they were vociferous in their opposition to nuclear weapons, they were now equally opposed to BMD. Having nuclear systems was presumed to make the U.S. and Western countries targets for attack, and now that more countries are acquiring such systems, these advocacy groups are equally passionate in their desire to leave them undefended.

In the context of enhanced security, Lady Thatcher considered global BMD to be much preferable to an American NMD. An alliance system would offer more options and significantly enhance the chances of boost-phase intercepts. Such an approach would help to solidify NATO, while reinforcing America's position as the global superpower. In making these proposals, she made it quite clear that global BMD would be expensive, and that allies must be prepared to share the costs. She dismissed the Russian invitation to consider a European BMD

[3] M. Thatcher, "Clear and Present Danger," *Washington Times*, July 7, 2000, p. A19.

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system[4] as just talk designed to drive a wedge between America and its NATO partners. The idea of a European-only BMD could equally be dismissed as mere talk. Without American participation, Europe has neither the resources nor the will to go it alone.

Without attempting to define any technical solutions, the former British Prime Minister made it clear that heavy investment in an unsatisfactory system constrained by the restrictions of the ABM Treaty must be avoided. It is nonsense to claim that the ABM Treaty remains a cornerstone of strategic stability. In her opinion, the Treaty is now a worthless document that should be consigned to the shredder of history.

As noted above, there are other very different views of the New World Order. Even in America, where over $60B has been invested in research and development on the technologies associated with BMD, many remain opposed to the concept. What started as a criticism of National Missile Defense on the ground that the deployment of such a system would mean modifying or withdrawing from the ABM Treaty, has been extended to impose limitations on the capabilities of Theater Missile Defense (TMD). This results from calculations that show an effective TMD would have some slight capability of intercepting Intercontinental Ballistic Missiles (ICBMs), a capability that could be interpreted as contravening the ABM Treaty. Another interpretation of these claims of the detractors of BMD is that they are an attempt to degrade the capabilities of even the TMD to such an extent that its cost effectiveness will become questionable. Outside of America, most governments, with the exception of Israel, continue to oppose the acquisition of an NMD.[5] The stated objections relate mainly to ABM Treaty implications, but many other factors are thought likely to contribute toward their opposition.

The Limits of Diplomacy

Ambassador David Smith, writing in a Jane's publication (*Ballistic Missile Proliferation*, Chapter 5), calls for a "Full Spectrum Response", because facing missiles with WMD's with only negotiations, conferences and bits of paper is doomed to fail.[6] His suggestions touch on the

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[4] *New York Times* editorial, June 7, 2000.

[5] J. Hackett, "Double Standard on NMD Leaves U.S. Vulnerable," *Defense News*, September 9, 2000, p. 31.

[6] D. J. Smith, "The Limits of Diplomacy", Ballistic Missile Proliferation, *Jane's Special Report 2000*, p. 51-59.

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following topics:

1. Regional Security Diplomacy. This relates to the need to engage other nations early to ensure that the circumstances and perceptions that lead to proliferation are fully understood. Only then can alternatives be offered.

2. Improved Intelligence. This relates directly to the recommendations of the Rumsfeld Commission to keep a closer track of regional situations. Only through improved intelligence will it be possible to counter the denial, deception and concealment practiced by hostile regimes.

3. Technology. This is the West's trump card. Investment has to be made to develop the capabilities for intelligence collection, reconnaissance, WMD near and remote detection, BMD and consequence management.

4. (Pre-hostility) Interception and Pre-emption. This is a subject about which many may be skeptical, but the concept should be examined thoroughly. At least it will respond to critics who claim this is the way to avoid the expense of BMD. The later ramifications of Israel's attack on Iraq's Osirak reactor cannot be ignored. It therefore seems imperative to examine the political and legal ramifications. Such a study might lead to constructive changes in international law.

5. Retaliatory Capabilities. Like Lady Thatcher, Ambassador Smith considers that offensive deterrence must be retained. He believes some vigorous new thinking is required because the concepts of bipolar deterrence cannot simply be transferred to multiple adversaries and varied situations.

6. BMD. Again in concert with Lady Thatcher, he considers that BMD devalues every missile aimed against us. Missile Defense is complementary to non-proliferation and other responses. Nonetheless, supporting BMD complicates the dual-use dilemma of the Missile Technology Control Regime, MTCR. This is another example of an earlier arms control agreement that needs to be re-examined in the light of technology advances.

7. Counterforce. This capability is often advocated by critics of BMD, but is one that so far has been unsuccessful in limiting missile launches. Combined with this need to locate and destroy launch facilities, is the ability to strike underground facilities, which many hostile countries are now building.

8. Passive Defense and Consequence Management. Despite all our efforts and best intentions, hostilities may break out and if we

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are attacked some missiles may penetrate. To minimize the effects, passive defense measures cannot be neglected.

In contrast to the detractors, who would rely solely on diplomacy and international agreements to provide protection against missile attacks, the proposal made by Smith is to be adequately prepared for all eventualities.

The Lack of Response to the Growing Threat

There would be little benefit in listing here the details of proliferation since the end of Cold War. There are several publications illustrating that the size and sophistication of the threat grows annually.[7] Although some may disagree that mere possession constitutes a threat, there can be no disagreement that several more countries now have offensive missiles, and access to WMD's. Collaboration among these nations that we used to refer to as hostile has overcome their need to depend upon indigenous capabilities. The world security situation is very different from the bipolar world that generated the concept of Mutual Assured Destruction (MAD), the ABM Treaty and the MTCR. Despite this, most nations continue to deny any change in threat.[8]

The denial appears to result from a complex mixture of emotion, reluctance to abandon longstanding political concepts, technical uncertainty, and economics. When the British were developing Chevaline, there were constant debates about the size of the area the Soviets were able to defend with their ABM defense. Viewed objectively, these arguments were totally irrelevant. Regardless of what the Soviets wished to defend, Britain had to be able to penetrate it to maintain the status of deterrence. Exactly the same thesis operates today, but in reverse. Proliferators acquire BMs at least to threaten, if not to use. To nullify that threat, we need, as Thatcher and Smith have enumerated, a spectrum of responses including BMD. Without BMD there is no fall-back if deterrence and diplomacy fail.

As noted earlier, the ABM Treaty underlies much of the opposition to BMD. The reluctance to question it's relevance stems

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[7] R. Ranger & D. Wiencek, "Countering Proliferation", *Global Defence Review*, London 1999, p. 56-61; D. Lennox, *Jane's Strategic Weapon Systems, 1999*.

[8] E. Fox & S. Orman, "Motivations for Missile Defenses", *J. Social, Political and Economic Studies*, Vol. 24, No. 3, Fall 1999, p. 259-273.

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from the fact that it was the first Arms Control Treaty of the Cold War. Too many leaders developed their concepts of national and international security based on the Treaty, it has become an article of faith. The real test would be to identify leaders who would propose signing such a Treaty under present conditions. There are unlikely to be any, so it remains difficult to understand why so many still support retention of a Treaty, that ensures defenselessness. Scott McMahon reviewing the inter-relationship between threat reduction and the ABM Treaty suggested that abandonment of traditional strategic arms control processes succeeded by more proactive measures with Russia would be essential to enhance world security.[10]

Ambassador Smith pointed out that there is now an almost total lack of logic to support deterrence solely through the threat of retaliation. If deterrence fails and hostilities break out in this multipolar environment, Commanders in Chief will be presented with impossible choices. Even if the attacker can be identified, and that is by no means certain, what response should be made to a missile attack? Without any means of intercepting the missile, the only alternatives are to do nothing or to launch retaliatory missiles immediately after an attack has been detected. The problem then becomes the selection of the level of retaliation. Prior to the arrival of the missile there would be no way to know whether it carried conventional or WMD payloads, raising the question of whether a nuclear response would be justified. Few leaders would welcome being presented with these uncertainties at a time of extreme crisis. To add to the complexity, if the attack is ship- or air-launched the source may remain unknown for a prolonged period. From every angle it is clear that in the present environment there is little logic in the policy of remaining unprotected and relying solely upon international agreements to avoid hostilities. In terms of protecting the civilian population, nothing would be lost in providing a fall-back option in case deterrence fails.

This brings us to the question of technical viability, which has been used in two totally opposite forms by detractors of BMD. Claims have been made that the systems under development will be unable to provide any real protection, because they can easily be defeated by the addition of simple countermeasures (discussed in some detail below). Yet the same opponents suggest that the deployment of defenses will be destablizing because of their effectiveness and could therefore start a renewed arms race. Most European governments have fallen into this trap of inconsistency, as they deny the capability of missile defense

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while at the same time criticizing America for wishing to deploy a Nuclear Missile Defense.

With all the recent evidence of the growth of nationalism, resulting in a world far less stable than that prior to the breakup of Soviet Empire, it is ironic that most defense budgets have decreased as governments seek to reap a "peace dividend". To rectify these deficiencies would require a complete policy turnaround, something that has never been easy for political leaders. So we have entered a phase that denies a substantial change in the threat, coupled with the repeat of the mantra that the quality of the technology remains inadequate.

The American Program

Because of geography, America has always been able to draw a clear distinction between TMD & NMD. Most other countries do not have this luxury. As a result, America's leaders have pursued TMD, albeit with varying degrees of enthusiasm, while still lacking bipartisan support for an NMD program. The formal policy through the last five American administrations has been that TMD assets under development would provide protection for U.S. forces deployed overseas, and for allied forces and populations. This undertaking has enabled allied governments to put BMD on the back burner, in the expectation that America would provide the necessary assets when needed, as occurred when Patriot systems were transferred to Saudi Arabia and Israel during the Gulf War.

The longstanding investment in Patriot-updates will enable the Pac 3 to enter service soon. But because of cost growth, the number of interceptors that can be afforded is significantly less than were originally envisioned. The initial purchases of missiles and launchers fall well short of those required by the U.S. Army to meet the National Defense Strategy.[9] There certainly will not be a superfluity to protect allied assets for the foreseeable future.

The THAAD (Theater High Altitude Area Defense), which would provide an essential overlay for the lower tier Pac 3 interceptor, is still not scheduled to enter service until 2007, although plans are in hand to once again attempt to bring the date forward a year.[10] (Previous such

[9] *Defense Week*, November 13, 2000.
[10] *Defense Daily*, October 20, 2000, pp. 3, 4.

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attempts led to the concept of a User Operational Evaluation System, but the two different standards so distorted the program that the effort was abandoned).[11] Until THAAD becomes operational, the TMD will have a very limited capability, because the Pac 3, which was designed to intercept leakers in the terminal phases of their flight, has a very small protected footprint on the ground. As a simple guide, it can be assumed that the higher the altitude at which the interceptor operates, the larger the area on the ground that can be protected. The THAAD was thus designed to provide large-area protection. The lower tier Pac 3 cannot achieve city-wide defense alone.[12]

A further layer of complexity is provided by the limitations that have been imposed on the THAAD performance. These restrictions were introduced because of the criticism that the system had a possible residual capability to intercept ICBMs, and have the effect of degrading the initial design performance. Thus although the ABM Treaty does not apply to TMD, it has been invoked to limit the capability of the THAAD to a degree that will undoubtedly make TMD less effective, and even bring into question whether with the reduced effectiveness, the system would be worth acquiring at all.[13]

Having used the ABM Treaty to degrade the quality of the TMD system under development, the United States decreed in late summer 2000 that a decision on the deployment of an American NMD would be deferred until the next administration.[14] This was ostensibly taken on the ground that the technology was not yet mature enough to proceed. The failure of an NMD development test in August provided the excuse to free the Clinton Administration from the horns of a dilemma regarding NMD. The President had declared early in his first term that the ABM Treaty remains the cornerstone of national security, despite the fact that the Treaty expressly excludes national missile defense. All attempts over the past seven years to negotiate minor modifications with Russia to allow an NMD to be deployed have been unsuccessful.

Last year, in response to the passage of a Missile Defense Act,

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[11] E. Fox & S. Orman, "The Limitations in American Capabilities for Missile Defense", *J. Social, Political and Economic Studies*, Vol. 22, No. 3, Fall 1997, pp. 259-265.

[12] D. J. Smith, "Missile Defense After Helsinki", *Comparative Strategy, 16*, 1997, pp. 369-376.

[13] D. J. Smith, Beyond The Cold War", *Sea Power*, November 2000, pp. 42-44.

[14] B. Gertz, *The Washington Times*, July 26, 1999.

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President Clinton promulgated four requirements that he decided had to be taken into consideration before entering into the NMD deployment phase[15]. These were: the level of threat, technical viability, the effect on international arms control, and cost. By passage of the Act, Congress had already reacted to the growing threat, which certainly has not declined as proliferation continues to increase. The technical viability of the individual subsystems that would constitute the defense has been demonstrated. The cost estimates vary, but none are beyond affordability, leaving only the effect on international arms control as the stumbling block. In the Clinton Administration, arms control was a code word for retention of the ABM Treaty, and therein lies the problem.

The reason given by that administration for delaying the start of construction of the radar on Shemya in Alaska was attributed to the failure of a flight test. If the Administration had been genuinely committed to the policy of achieving an NMD by the earliest possible date, development tests would have been accepted as mere steps along a path, and not as make-or-break events. The policy would be protected by taking the actions required to maintain the critical path to initial operating capability. In this particular case the construction of the radar happens to lie on the critical path for system deployment, whereas a further two years are available before the performance of the interceptor has to be proven so that it can enter initial production. Thus, President Clinton's decision, which ensures fielding will be delayed, with inevitable cost growth, was unnecessary from a technological viewpoint and appears to have been taken purely on political grounds.

Further confusion has been added to this already extremely complex topic by the claims of the Union of Concerned Scientists (UCS) that the proposed NMD can be defeated easily by the inclusion of simple countermeasures.[15] Although their claims have been refuted by experienced missile designers, who have shown of a total lack of appreciation by the UCS of the system engineering complexities,[16]

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[15] Countermeasures, The Union of Concerned Scientists, *MIT Security Studies Program*, April 2000.

[16] K.S. McMahon, S. Orman & R. Speier, "Countermeasure Double Talk", *Defense News*, June 19, 2000, p. 19 ; J. Hackett & S. Orman, "The Countermeasure Debate", *The Washington Times*, August 9, 2000, p. A16 ; U. Rubin, "Comments on the UCS Report on Countermeasures", *Israel*, July 18, 2000.

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their claims may well have affected the presidential decision to delay implementation.

Supporters of the concept of NMD are by no means unanimous in endorsing the ground-based architecture selected for the initial deployment. Those who would prefer a sea-based system, utilizing the facilities already installed on the Aegis class of ships, point to the possibility of using strategically placed ships to achieve a boost phase intercept.[17] There are several advantages associated with early interception, such as destroying the missile before it can dispense its payload, and ensuring that the debris falls back close to the launch area. However, the fast-acceleration interceptor missiles that would be required for such a system are not yet in development, and the ABM Treaty problems associated with the present architecture would present even greater difficulties to a mobile system. It is unfortunate that the supporters of the two different systems each make extravagant claims about how quickly and cheaply each can be made available, effectively undermining confidence in the concept itself.

There should be no doubt that any system as complex as the NMD will require several years of refinement to achieve high efficiency. That is one of the reasons it is considered by some to be so important to get a rudimentary system deployed as soon as possible. It is only through the operation of an NMD system by the Services that the required enhancements can be identified, developed and incorporated. If this program is ever to be successful, there has to be a complete break from the present limitations stemming from international opinion and from the constraints of the ABM Treaty, which have imposed ridiculous restrictions on the system architecture and have even limited the testing of system capabilities.

An NMD cannot be developed halfheartedly; if it is to be accomplished, it has to be done properly. The non-technical obstacles have to be removed, initially with a clear statement of intent that is coupled with a firm requirement. The most capable personnel will have to be made available to managers mandated with the task, managers with a proven track record of development and acquisition. In turn, these managers will have to be provided with the appropriate authority to discharge their responsibility. None of these measures has been adopted in the past, which is the principal reason no missile defense is

[17] J. Carey, "Missile Shield From the Sea", *Defense News*, March 29, 1999, p. 19

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available to protect American cities nearly 18 years after President Reagan started the SDI program. The production of an NMD will be neither cheap nor easy, but if America is to remain the leading world power it will certainly need one.

In contrast to the mismanagement that has characterized the American NMD activities, Israel has just announced that it has an effective ballistic missile defense system based on the Arrow missile.[18] Does anyone really doubt that America with all the resources at its command could not achieve a similar level of success? The individual components that would comprise the initial defense have been proven in the development programs instituted since 1983. The improvements in sensing, guidance and computing have enabled interceptors to be designed that do not require nuclear warheads, as still used in the Russian ABM system. The conceptual, initial American NMD would provide the essential first step toward a more secure future. Adopting the procedure outlined above would lead to a first fielding, that although far from perfect, will be able to grow with time. This growth can result from technology improvements, from geopolitical changes, or from the growth in the sophistication of the threat, which will occur with or without the advocated deployment. The driving force for future enhancements is unimportant at this stage, only the fact that the system will be given the capacity to develop if needed.[19]

The mere possibility that America would deploy even a limited capability NMD caused an outburst of criticism from the Russian and Chinese governments that bordered on hysterical.[20] Their claims were that it would be destabilizing, it would lead to a new arms race, and it would destroy existing arms agreements. The very concept was presented as the worst of all possible moves from their point of view. This alone should have given the American administration and those of its allies food for thought. Yet instead of recognizing that the American NMD would limit others' attempts to restrict Western foreign policy initiatives calculated to further democracy and freedom, allies

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[18] Editorial, "Modern Missile Defense", *The Jerusalem Post*, September 18, 2000.

[19] E. Fox & S. Orman, "Make Commitment to NMD", *Defense News*, November 6, 2000, p. 19.

[20] *Carnegie Endowment Proliferation Brief*, February 11, 1999; B. Schweid, "Missile Shield Won't Stop Russia", *The Washington Times*, November 11, 1999: D. Struck, "Asian Forum Ends in Chorus of Criticism of U.S. NMD", *The Washington Post*, July 30, 2000, p. A32.

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and many within America joined the chorus against a missile defense. The existence of the Soviet ABM defense, inherited and maintained by Russia, seems to have been forgotten. Their defense, which has been deployed and enhanced over almost a quarter of a century, has not led to instability; so why should an American defense be destabilizing? Equally overlooked in the general clamor to dissuade America from proceeding is the hollow nature of the threat that the deployment of an NMD would cause Russia and China to invest more heavily in offensive systems to overwhelm the defense. Russia will have to reduce its offensive forces regardless of whether further arms reduction treaties are agreed upon, because it cannot afford to maintain those it has now; further increases are clearly unaffordable. The Chinese after many years of effort still have very few (ICBMs), and the prospect of their acquiring sufficient numbers to overwhelm an effective NMD in the foreseeable future is extremely remote. In summary, there has until early 2001 been nothing but a lack of political will within the Clinton Administration that has prevented America's proceeding with the plans to acquire an NMD.

Issues Affecting Defense Decisions

In 1997, in an attempt better to understand the issues that influence major defense policy decisions, the present authors considered the contribution made by each of a range of topics.[21] The individual issues, which were not claimed to be exhaustive but were certainly representative of national attitudes, were identified as whether there was:

. An undisputed recognition of the threat;
. A military requirement to counter the threat;
. Public and government support for the activity;
. The technical capability;
. Financial commitment to complete the work; and
. Freedom to proceed under international treaties.

A grading from one to ten was given to each topic, according to the assessed importance in terms of U.S. defense policy. The

[21] E. Fox & S. Orman, "Why The U.S. Still Lacks an NMD", *J. Social, Political and Economic Studies*, Vol. 22, No. 2, Summer 1997, pp. 131-141.

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assumption was that an overall mark of 75% would indicate that the nation was taking the requirement seriously. When the score turned out to be 40%, the conclusion at that time was that America was well away from committing to such a scheme. The national outlook on each of those issues with regard to BMD in America and Europe was re-examined in 1999 after passage of the Missile Defense Act to assess whether there had been a significant change in attitudes and whether there was a greater likelihood then of Europe participating in such activities.[22]

The results of this second assessment showed that although the American score had risen from 40 to 65%, it was still well short of that necessary to indicate a strong commitment to the program. Thus, it came as no surprise when President Clinton decided not to proceed into an acquisition phase. The score for Europe was assessed at the 20% level, and there is little to indicate that their position has changed recently. The vocal opposition of the NATO allies to the U.S. proposals to consider an NMD is fully consistent with this earlier conclusion. These assessments contrasted starkly with the Israeli position, as to which a similar analysis would have yielded a mark exceeding 90%; and this has been reflected in their achievement of being the first to deploy a non-nuclear BMD.

Is There a Way Forward?

The simple answer is that a way forward has to be found before a hostile nation, or a subnational grouping, makes it crystal clear that something should have been done earlier. In the absence of any defense, missiles against the United States or its allies do not have to be fired to be effective; the mere threat of their use may modify activities. For example, in future conflicts the mere possession by an aggressor of missiles with sufficient range to reach European capitals could be sufficient to preclude the formation of a multinational force such as operated in Kosovo or the Gulf. This could be true even if uncertainty remained regarding the possibility of WMDs being involved. How many European Governments would be prepared to subject their populations to the fear that gripped Israel during the Gulf War when Iraq launched Scud missiles that might have carried chemical warheads?

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[22] E. Fox & S. Orman, "Will Europe Invest in Missile Defense?", *J. Social, Political and Economic Studies*, Vol. 24, No. 1, Spring 1999, pp. 3-16.

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Article 1 of the ABM Treaty prohibits any missile defense of the whole country, and no amount of legal wording can obfuscate that fact. Moscow has made it clear that changes to the Treaty will be firmly opposed, and is busily engaged in diplomatic moves to garner support for this position. Russia's principal ally in this endeavor is China. Although not a party to the Treaty, which was between America and the Former Soviet Union, China claims an interest in the global stability that the Treaty is believed to underpin.[23]

China has a clear policy to develop and maintain the ability to hold a few major American West Coast cities at risk. China does this in the belief that such a capability would be sufficient to deter America from intervening in matters that Beijing considers vital to its own interests. The deployment of even a limited NMD could undermine China's long-planned modernization effort of new ICBMs to provide this so-called retaliatory force. Unlike Russia, China is also strongly opposed to U.S. plans for a TMD. This opposition is on the ground that such a system in Asia would remove their single strategic card in that region. Repeated claims that the proposed American systems are not directed against China or Russia cut little ice, because clearly their acquisition would affect the current policies of both these nations.

The NATO allies, too, have clearly become concerned about the heightened tension that could result from the above diplomatic exchanges.[24] This concern is exacerbated by the belief that the deployment of an NMD will lead to different security standards for America and Europe. This concern would be eliminated by an acknowledgment that Europe, too, could and should be defended against ballistic missiles. This debate is sharpened by the fact that the effectiveness of the proposed American system depends upon major upgrades in radars currently operating at Thule, in Greenland (under Danish sovereignty) and at Fylingdales in England. So these countries have been drawn, however unwillingly, into the debate generated by the actions of the previous Clinton administration.

It was mentioned earlier that the denial of a threat to homelands by European governments appears to result from a complex mixture of emotion, reluctance to abandon longstanding political concepts, and economics.

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[23] R. Ranger & D. Wiencek, "U.S. Must Resist Chinese Pressure Against Missile Defense", *Defense News*, June 21, 1999.

[24] *Carnegie Endowment Proliferation Brief*, Vol 111, No. 28, September 21, 2000.

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Yet despite this apparent lack of concern for population defense, the leading European NATO countries have recognized a requirement to ensure a rapid deployment force has some protection against missile attack. Somewhat belatedly governments recognize they may have been mislead by repeated claims that the American TMD will protect allied assets. It is now clear that the number of systems on order fall short of those needed solely for U.S. requirements. Also, until the upper tier interceptors still under development become available, in about 2007, there can no effective area defense.

The Europeans have produced some elements of missile defense that could form the basis of cooperative programs. The French will start deployment of Aster in a naval variant in 2001, with a ground-based system to follow. The British will deploy an active phased array radar in a naval variant, SAMPSON, with enhanced performance. Germany and Italy are collaborating with the U.S. in the development of the Medium Extended Air Defense System (MEADS), and Germany and the Netherlands are upgrading their Patriots to PAC-3. Other systems under development in NATO allies promise significant capability against cruise missiles, which are likely to become the offensive system of choice for many nations, because of the relatively small investment required compared to ballistic missiles.

There have been two previous serious miscalculations in dealing with NATO allies on missile defense issues. The first was President Reagan's surprise announcement of SDI and the second was President Clinton's initial acceptance of National Missile Defense, NMD. The new Administration must ensure therefore that allied concerns are considered before committing to a new policy. President's Bush's selection of Powell, Rumsfeld and Rice as the nucleus of his National Security Team indicates that the enhancement of deterrence through the acquisition of ballistic missile defense will be a major factor in his Administration's defense policy. This makes it imperative that American policy makers prepare the political ground carefully.

A clear statement of intent should be enunciated early on, followed by comprehensive consultations, under American leadership, to ensure that long-standing allies remain partners in enhancing security arrangements. Cooperation on BMD between America and it's NATO allies can only proceed if America, as the dominant partner, provides the policy and leadership that has been lacking for so long. Without debating the merits of the different architectures that are being proposed for an NMD, it is evident that several subsystems can be

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common between the defenses required for America, for Europe, and for forces operating out of area. The manner in which these are identified, and their acquisition shared between the allies, will greatly influence the European attitude. America must be prepared to come forward with a policy of inclusion, while making it abundantly clear that the decision to acquire an NMD is not open to modification. The offer of inclusion should be confined to the European and out-of-area defensive needs. What is required above all else, is the elusive quality of leadership. It is almost ironic that in the Clinton Administration's final days the Pentagon should have announced the formation of missile defense policy office to focus on approval and coordination of matters related to BMD in support of Presidential guidance.[25]

A comprehensive review of the policy issues and technological capabilities of NMD by Tanks and published in July 2000 by the Institute for Foreign Policy Analysis reached a similar conclusion. It noted that progress would remain inadequate without the provision of a strategic plan. NMD and future arms control efforts would only be effective if pursued as a means to a larger end, and not as an end in and of themselves.[26]

The above recommendations for the new Bush Administration, might present some difficulties because the newly elected government may have to build a consensus to move forward on such a major issue. Despite the case made herein for hard decisions on NMD and TMD to be made urgently, an equally likely outcome is for these to be deferred, while the new Government establishes confidence by concentrating on domestic issues. The BMD programs have sufficient momentum to continue and are in no danger whatsoever of being curtailed. The most probable outcome is a rapid agreement to proceed with the development of both NMD and TMD systems, without reaching any decision on the contentious issue of deployment, beyond that of Patriot Pac 3, which is moving into that phase now. An inevitable result of such delays will be cost growth in the programs, possibly accompanied by increased instability in various regions around the world, until an unequivocal statement of an acquisition policy is announced.

Such an announcement will have the dual advantage of enabling development to proceed without making each flight test a critical

[25] B. Gertz, *Washington Times*, "Inside the Ring", December 1, 2000.
[26] D. Tanks, "A Study On NMD", IFPA, July 2000 (www.ifpa.org).

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decision milestone, while at the same time making it clear to all, including European allies, that the ground rules have changed. The message should be that America will take whatever steps are necessary to protect itself, and at the same time will cooperate with it's allies in Europe and elsewhere, if the latter are willing to participate.

As then Governor Bush proposed in his May 23, 2000 speech, American policy should be to "build effective missile defenses... to protect all 50 states – and our friends and allies and our deployed forces overseas." Accordingly, consideration should be given to dropping the "National" from NMD and adopting former British Prime Minister Lady Margaret Thatcher's term "Global Ballistic Missile Defense." With strong American leadership the worthwhile objectives of enhanced deterrence through the deployment of active missile defenses can be achieved by strengthening, rather than splitting alliances.

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THE ABM TREATY CHARADE:
A Study in Elite Illusion and Delusion

William T. Lee

Former CIA and DIA analyst of Soviet and U.S. missile programs

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The Microsoft Corporation in Collision with Antitrust Law

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Key Words: Anti-Trust law, Microsoft, Netscape, WordPerfect, economic freedom.

1. The Political Message of the Microsoft Case

When a professor at a university began his new job, he was told that Netscape Navigator was being added to his computer. He immediately asked if Microsoft's Internet Explorer was available. When the systems administrator protested that the two programs were identical, the professor clued him in on the reasons why many economists dislike Netscape.

Netscape dominated – some would even say "monopolized" – the

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Internet browser market through most of the 1990s. When it became apparent that Microsoft was going to offer it some serious competition, Netscape responded by intensifying its lobbying efforts in Washington, D.C., knowing that, despite its obvious market power, Microsoft had not yet developed helpful contacts among the political class, preferring instead to focus its resources on pleasing customers.

Netscape's strategy underscores a trend that has grown with the increased scope of government in public life, namely, that faced with market competition, firms now have three options: First, they can go out of business. Second, they can fight back by trying even harder to satisfy customer needs and wants better than their rivals. And third, they can now cajole their elected representatives to intervene in the market process by contributing directly to them or to their pet causes, making it costly or even impossible for meaningful competition to develop in the market at all.

The technical term that economists use for the third option is rent dissipation. It describes what happens when capital is invested in the political class rather than in productive efforts to satisfy customers. When this happens, the wealth-creation process is hampered considerably. The successful firms are those willing and able to "pay up" for the implied assurance that politicians will not throw obstacles in the way of the firms' attempt to participate in the market.

The costs of rent dissipation are perhaps more evident to economists, and they generally have admired Microsoft for refusing to play this game. Up to 1998, Microsoft had a meager lobbying presence in Washington, relative to its competitors; indeed, the company's enormous success seemed to highlight Washington's irrelevance to the market process.

It was only when Microsoft decided to offer serious competition to Netscape that the latter decided to cash in on some of its political investments in Washington. Soon thereafter, the term "antitrust" began to be bantered around in association with Microsoft. Four years later, on November 5, 1999, Judge Thomas Penfield Jackson made it official. Microsoft was going to pay for not ponying up when it had the chance.

Just weeks before this ruling was announced, Microsoft Chairman Bill Gates announced that, through his foundation, he was funneling $1 billion to organizations that provided scholarships to black Americans. Two weeks following the ruling, the government announced it would be going into arbitration with Microsoft to determine exactly how its case should proceed, if at all. It was announced that Judge Richard Posner,

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a libertarian and Chicago School trained legal scholar, was to hear the arbitration, much to the surprise of Microsoft's enemies.

Could there be a connection between the two events? Is it possible that Gates is trying to communicate, through his actions, to the political class that he has finally learned about the need to be compliant, albeit somewhat late in the day?

At least since the development of income tax withholding as an emergency measure during World War II, American business, to varying but astounding degrees, has been forced to do the bidding of the state. To the degree this has been made possible, business has been nationalized. Firms learned that to be successful there were two sets of customers that had to be satisfied: the conventional ones who consumed their products, and the regulators.

After all, both had the power to make or break their businesses. Successful firms today still must satisfy the consumer in order to remain in business, but they also must please the political class as well. Failure to do either can spell doom for the naive firm.

The reason Microsoft caught the attention of so many free market economists was that its success challenged this regime. This undoubtedly scared the political class enough to force Microsoft to pay for ignoring it. At first, it looked as if the state had finally picked a fight with an adversary that had the capability to fight back, and millions of taxpayer dollars were paid out in lawyers' hours in this effort.

With its initial victory in Judge Jackson's November 1999 ruling, the government is implicitly sending a message to the entrepreneurial class: if it can force Microsoft to play by its rules, then it can make any other firm comply as well.

What Frederic Bastiat wrote 150 years ago applies just as much today:

> Sometimes the law defends plunder and participates in it. Thus the beneficiaries are spared shame, danger, and scruple which their acts would otherwise involve. Sometimes the law places the whole apparatus of judges, police, prisons, and gendarmes at the service of the plunderers, and treats the victim when he defends himself as a criminal. In short, there is legal plunder.(12, p. 20)

2. Leave Microsoft to the Market

Governments do not fix or solve monopolies, they cause them (e.g.,

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the United States Postal Service). In a capitalistic society, markets determine the prices, quantities and qualities of goods traded. Without any government interference, there cannot be a monopoly because prices are based on competition. That is, as long as new firm entry is legal, monopoly is impossible (26). The number of suppliers is irrelevant because if there is just one of them, that supplier has to keep its prices reasonable and its goods or services superior to anyone who *might* enter the market to serve the consumer better and reduce its share. There is no reason to fear exploitation by single suppliers, unless the government protects them (1). In a free market, today's dominant company could be tomorrow's rubble (2). Anyone is free to enter the market at any time and compete for a share. The consumer benefits all the way, because the threat of competition to producers ensures low prices and high quality. Austrian economists have long demonstrated that competition is a process, not a moment frozen in time (2, 22). The government cannot set up competition, because competition does not call for a certain number of competitors or a government-defined market share; it simply requires open entry rules for everyone(1). The government is not capable of intelligently micro-managing business innovation, just as it would be a logical impossibility for the free market to effectively restrain trade (3).

Successful companies spend enormous amounts of money, time and effort to please the consumer with excellent service and the most value for money. Companies that do not offer as much or that offer inferior goods or services do not grow and eventually self-implode. Microsoft, a company that has increased the efficiency of nearly every person on the planet, is now a government target because it is making a profit in the process of serving its customers – without rendering proper deference to its political masters. Microsoft is one of the biggest and most successful companies in the world today because it keeps its products state-of-the-art and easy to use.

In the wake of Microsoft's success lie the charred remains of many of its rivals who could not keep up with the fast pace that this firm sets in the computer industry. Lotus and Apple Operating System lost users to their Microsoft equivalent. Alan Ashton, president of WordPerfect, which has lost almost its entire market share to Microsoft Word, calls Microsoft "a threat to everybody in the industry" (4). However, that is just the way it works—if the customers like a product, they will buy it. Microsoft's policy of serving the needs of its customers by leading the software industry and adding zero priced software for better value,

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is now an issue pending before the Supreme Court.

Why is Microsoft being lead to the stake by Judge Jackson? Mr. Gates chose to compete by developing better products at a lower price (5). His motto should be "Integrate and Bundle" because stand-alone software products are routinely bundled into upgrades of Windows (1). This practice started with word processors, spreadsheets, calculators, games, and, more recently, an operating system used to navigate the World Wide Web: Microsoft's Internet Explorer (1). Customers love this practice (1). Netscape makes an Internet browser that is roughly comparable to Microsoft?s Internet Explorer. Now that Internet Explorer is part of the Windows Operating system, and is added to the vast majority of new computers, Netscape is having great difficulty selling what Microsoft includes in its own system at no extra cost. In condemning this behavior, Jackson describes Microsoft's access kits: they provided a simple and convenient way for users (including any Internet Access Provider) who clicked onto Microsoft's website to download the access kit free of charge (5). Nine months later, Netscape's Mission Control was released, with a staggering price tag of $1,995. Most Internet Access providers took the Microsoft deal, and made this product their preferred Internet browser (5). Microsoft is being punished for providing a superior product to the public for nearly $2,000 less than its competitor, and doing it earlier. Conceivably, Netscape might have had a legal case had Microsoft configured Windows to repel Netscape's Navigator (5). Indeed, by virtue of controlling the hub position, Microsoft could have been guilty of an antitrust violation if it had impeded Netscape's ability to run on the Microsoft system (5); however, this did not happen. Microsoft did not exclude Netscape from a stronger position; it only out-played Netscape under conditions of fair competition.

It is our prediction that Gates and Co. would, at least as a matter of law, have run afoul of the Justice Department under these stipulated conditions (e.g., precluding Netscape entry by offering a competitive service.) However, since we favor the repeal of antitrust law root and branch (13, 14, 15, 17, 18, 21, 24, 26, 27, 28), this would hardly be a welcome result from our perspective.

Janet Reno, while she was Attorney General, and other Microsoft critics have claimed to believe that what is bad for Microsoft is good for the rest of the computer industry and vice versa because of this company's allegedly "exclusionary" practices (4). But this entire concept is intellectually incoherent. In a sense, *any* sale or purchase is

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"exclusionary" in that it precludes all others. If A gives to B an "a" in return for the latter's "b," then by necessity each of them is excluded from trading these items with other people. A is no longer free to sell this particular "a" to all comers since, after the sale, it is now owned by B. Similarly, if C and D marry each other, neither is then free to marry anyone else. The "forsaking" of all other potential marriage partners is logically indistinguishable from excluding all other business partners. The necessary implication of antitrust is that it comprises a ban on all marriages in that they are "restraints of trade."

These "exclusionary practices" have not been proved; in fact, millions of computers have been sold that would not have been without Microsoft's so-called monopoly, and their software designers were able to develop products for the largest possible market (6). Users had the confidence to buy computers and software knowing that the industry had a powerful incentive to introduce innovations in a way that would be compatible with the items the users were already buying (6). It is charged that Microsoft uses its operating system monopoly to gain control over the Internet. Ironically, the established incumbent in the browser market was Netscape, not Microsoft. Microsoft had to scramble to offset Netscape's market dominance, even on computers that ran on the Microsoft system. It is hardly in the interest of consumers for Microsoft to cede this vital niche to an incumbent (5). Microsoft is therefore not restricting the market by setting the standard, but rather enhancing the possibility of building on the Microsoft structure (the way everyone else does) that already works.

Thanks to Microsoft, and the pressure it puts on others also to innovate, we are linked as never before in a vast and growing global network of information and commerce (7). Some companies are not up to the challenge. Businesses that cannot compete typically complain that their competitors have unfair advantages that the law should condemn (3). Netscape cannot stand up to Microsoft in a free market so it has to rely on uninformed government officials to reduce the efficiency of the latter. That this cheats the customer out of zero priced software is of little concern. While the majority of companies usually experience appreciation in their stock price when Microsoft receives good news, the returns of a few, such as Netscape, sometimes enjoy increased stock prices when the opposite occurs. This explains their instigation of the political assault upon their rival (4).

Netscape's CEO, James Barksdale, and its general counsel, Roberta Katz, were tireless in lobbying the media and Congress (6). Netscape

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is viciously attempting to achieve through politics what it failed to achieve in the competitive marketplace (4). Other successful businesses have been sued and ruined economically by regulators and second-rate competitors; but this system of business regulation decreases the welfare both of consumers who ultimately pay for the ensuing loss of efficiency and of the owners of the more effective firms (2).

Netscape would not be able to get away with this in a free society. It would not be able to help drag an entrepreneur into a Star Chamber, to be grilled by menacing G-men who have never performed a productive act in their lives (7). Here, the government is trying to "fix" the one part of our economy that is unimpeachably working well (6). The schools may be falling apart. The drug war may be a disaster. The military may be overworked, underpaid, and under-supplied. But, by golly, we're going to teach Bill Gates a lesson (6). In a more just and rational world, the president of Microsoft would be celebrated as an economic champion who broke technological barriers in the cause of human betterment (7). This was not to be, since the government and special interest groups have little or no regard for what the consumers choose. In an earlier antitrust era, the government frittered our precious tax dollars away on silly questions of horizontal price fixing, mergers, predation and tie-ins (5). But Austrian scholarship demonstrated that these diversions were always costly and counterproductive (5, 13, 14, 15, 17, 18, 21, 24, 26, 27, 28). The Microsoft case gave the government a chance to demonstrate how its refined understanding of antitrust theory could improve technology in the computer age (5).

Every time a software package is sold, a customer reveals his preference, based on quality, service, price and value. To put decisions of software integration, production or technological change in the hands of government is economic lunacy of the highest order (3). If Microsoft is pursuing the wrong strategy, the system of laissez faire capitalism will punish it (2). Power in the market is a contradiction in terms. Only government, never business (even where there is only a single seller of an item), can compel customers and stockholders to do anything (2). Lawyers in the Clinton justice Department could not to pass up the career opportunity of a lifetime. (6) That is part of the reason why the antitrust bureaucracy exists, and the Microsoft case has opened avenues to the creation of "new law" that can be turned into gold (6). Microsoft is a victim of regulatory extortion where the political establishment extracts "protection money" from it in return for its

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promises to allow the company to exist (4). We merely need to leave Microsoft to its own competitive devices; the market will reward or punish and the consumer will be the ultimate winner.

With the advent of a new presidential administration defining antitrust policy, the question of how Microsoft will be treated arises. President Bush had made it clear that the Microsoft case is up to the courts, and he would not intervene either for or against the software giant. If Microsoft survives the present appeal process, one would assume that the Microsoft's ordeal would end.

3. Mediation

Judge Jackson had agreed to have his colleague Judge Richard Posner serve as a mediator in the Microsoft antitrust lawsuit. This provokes several questions and issues.

First, it raises anew the legal legitimacy of antitrust law. For if this is a licit enactment, from whence comes the need for mediation? Consider the law against murder in this regard. If a man is convicted of this crime, there is no need for "mediation" between the criminal and the law enforcement agency. This is clearly a legitimate law, in that it is a violation of basic canons of justice to murder someone. There is absolutely no role to be played by a mediator, struggling to bring an understanding or a compromise, between police and criminal. If a violator of antitrust were truly a lawbreaker, the same, it would be thought, would apply in his case. On the other hand, it seems clear that the obverse is also correct: if there *is* a need for a mediator, as Jackson has now declared, then, and to that extent, there is no law in the first place the violation of which is a clear and unambiguous crime.

Further underscoring the difference between antitrust law and legitimate legislative enactments is the fact that there is no possible act that the accused could possibly undertake that would render him innocent. The company founded by Mr. Gates was held guilty of overcharging by Judge Jackson. However, what other possibilities were available to Microsoft? Had it charged less than its competitors, it would have opened itself up to the crime of undercharging, or predatory pricing, or cutthroat competition. Here, the accusation would have been that Gates was charging less than he might have, in an effort to drive his competitors into bankruptcy. There is only one additional alternative to over or undercharging; and that is, charging the *same* price as everyone else. But this too, under antitrust, is a crime: collusion.

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Say what you will about the crime of murder: at least the guilty party had a choice. He *could* have refrained from this foul deed. Had he done so, the presumption is that he would have suffered no penalty. In sharp contrast, this scenario was *not* open to Bill Gates. No matter *what* he did, no matter *how* he acted, he was open to the charge of monopolizing. As such, antitrust is *not* a proper crime, under the rule of law (20).

Second, Judge Jackson's appointment of Judge Posner as mediator opens the question of what results, in retrospect, we might have expected from Posner's decision. That is, could Posner have been expected to have taken a principled stance against antitrust, as a *per se* violation of the rule of law, or not? Although it was impossible before hand to predict with any degree of certainty the future actions of a jurist in cases of this sort, Judge Posner comes to the table with a long paper trail (25), on the basis of which we could have made some predictions.

And the prognostication, unfortunately, is not as good as it could be. Posner has a reputation as being open to free enterprise and opposed to government regulation, and, on the whole, this is well deserved, at least compared with most present inhabitants of the bench. However, he is not opposed to antitrust legislation as a matter of principle. Rather, he does see a proper role for this legislation (25, pp. 249-297).

4. Economic Freedom, Monopoly and the Government

What distinguishes the U.S. postal system from Staples, Toys "R" Us, Rockefeller's Standard Oil, Sara Lee, Eastman Kodak and Microsoft?

The former company is a monopoly; the latter are not, but have been so accused in accordance with antitrust legislation (29). The U.S. Post Office is a monopoly because its market dominance is derived not from what it offers consumers, but from an exclusive grant of government privilege. As monopolies, the postal service and the local gas and electric companies do not compete or engage in a voluntary exchange with consumers. Rather, they control the market by forcibly prohibiting others from entering it.

Extend this premise, and you arrive at the natural conclusion that in a free market where voluntary exchange between consenting adults is the guiding principle in trade, there can be no monopoly other than that created by government. How is it then that Microsoft is being hounded for being a monopoly? This is made possible through legislation that frames as predatory the process whereby an innovator

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captures a large market share. This despite the fact that the only way to capture a large portion of the market is by dint of government legislation, as the post office does, or through offering good service for a very low price, as Microsoft does.

Recall that as a competitive strategy, Microsoft had bundled its Internet Explorer with its Windows operating system. It did so for free, and with the aim of *outdoing* the competition. Microsoft then licensed its operating system to PC manufacturers with the proviso that they take free of charge its Internet Explorer. Fully within its legal right, Microsoft asserted copyright to prevent any reconfiguration of its operating system. Were users prohibited from loading Netscape's Navigator or any other Intel-compatible operating system on to their PCs? Of course not. Could Microsoft have prevented PC makers from installing competitive products? Absolutely not. That Netscape lost revenue is evidence of nothing more than Microsoft's competitive edge and Netscape's failure to offer the consumer a similar deal. Netscape then ran to Uberbureaucrat Joe Klein of the U.S. Justice Department for a remedy.

Clearly, Microsoft has arrived at its considerable market share by offering the consumer more total product for the least cost. Let's imagine, however, that there was a way to eliminate competition in a free market other than by government decree. Such an evil empire could restrict its sales with the intent of raising prices and doing some serious profiteering (30).

But had Microsoft charged a high price for the browser it tied gratis to its Windows operating system, its rivals would have been thrilled, and well-positioned to take such a market by storm. Incidentally, flexible antitrust law would have nabbed the company for predation under this contingency as well. It so happened Microsoft did the opposite: It gave away the browser. It was then that Judge Jackson, in a decision more voodoo than veracious, proceeded to declare Microsoft a monopoly.

The other mischief Microsoft might have attempted so as to drive and keep out competition would have been to drop its total product price even lower. But to be truly "predatory," Microsoft would have to have kept it there over time, eventually going bust. For the duration that it managed such a Kamikaze feat, its rock-bottom prices would be benefiting consumers, which goes to show that, government monopolies excepted, there is no such thing as a predatory price.

Despite a 1998 court decision that magnanimously upheld

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Microsoft's right to tie the two products, coupling the browser to Windows, according to Judge Jackson's Conclusions of Law, this was not only incontrovertible proof of a monopoly and harmful to consumers, but part of Microsoft's "larger campaign to quash innovation that threatened its monopoly position" (31).

What of the objection then that by bundling its Internet Explorer with its Windows operating system, Microsoft failed to offer the consumer a choice? What of the contention that it is attempting to freeze out other suppliers, as well as prohibit consumers from coupling one of these Microsoft products with that of one of this companies' competitors? One problem with this line of reasoning is that it attempts to discern the motives of businessmen. This is always a risky procedure, too uncertain to support a judicial finding of wrongdoing. Another more grave difficulty with this charge is that it is open to a *reductio ad absurdum*: were this act to be made the basis of unlawful behavior, we would have jails overflowing with white-collar victimless criminals. For example, it is impossible to purchase a McDonald's burger coupled with a Wendy's bun; neither fast food establishment will make such a concoction available. The consumer who wishes this particular combination of goods will just have to visit each store, buy a burger from each, toss out the McDonalds bun and the Wendy's burger, and eat whatever remains. Similarly, it is impossible to purchase a Ford chassis and a BMW motor. Those who wish to drive in such an unusual mixture will be forced to buy one of each of these automobiles, and fashion this amalgamation for themselves. However, if we are going to penalize Microsoft legally on this ground, we must also include in the indictment all fast-food purveyors, all automobile companies, all TV manufacturers (some consumers may wish the SONY innards and the RCA tube or vice versa), all publishers (some readers may want the cover of the bible and the inner pages of Lolita or Playboy, or, who knows, vice versa), etc. In short, the indictment would have to catch any entrepreneur who has irked someone with the way he has configured a product.

Antitrust legislation considers a large market share or a concentration in the market to signify both monopoly and predatory practices on the part of a company. As such, the antitrust chimera is based on discredited theories about competition. Relying as it does on a model of ideal or perfect rather than rivalrous competition, the legislation aims at a market neatly carved among competitors (32).

Judge Jackson's circular reasoning culminated in his asserting that

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the fact Explorer is not "the best breed of Web browser" (31) is further evidence of Microsoft's predatory behavior. If the proliferation of bad products on the market is an indication of a lack of fair competition, we ought to sue rapper Puff Daddy on behalf of Johann Sebastian Bach.

5. MS-Nationalization

When Judge Jackson "ordered, adjudged, and decreed" the breakup of Microsoft into two separate companies, he effectively replaced Bill Gates with government lawyer Joel Klein as the chief decision-maker of the Microsoft Corporation. The Judge accepted almost verbatim the Clinton administration's breakup proposal, authored by Klein and his colleagues in the corrupt Reno "Justice" Department (with the help and advice of Microsoft's competitors), effectively nationalizing the company.

There is no more competitive industry than the computer industry, where the dynamic market process has produced a company like Microsoft, which produces both a computer operating system and applications. The Soviet central-planning-style breakup scheme ordered by Judge Jackson abolishes what the competitive market process has produced and in its place puts a Byzantine regulatory regime that is to be administered by federal and state government lawyers. There could not possibly be anything more damaging to competition, economic rationality, and consumer welfare.

The judge's order effectively destroys Microsoft's ability to compete in the Web browser market, thereby making that market less competitive, and also prohibits the company from employing routine competitive devices that are used by thousands of other businesses, such as exclusive-dealing contracts and tie-in sales.

Judge Jackson even goes so far as to order a kind of forced labor by commanding Microsoft to "use all reasonable efforts to maintain and increase the sales and revenues of both the products produced or sold" prior to his order and to "support research and development" for such products.

Never mind that some of these products might become obsolete in the meantime, as they frequently do in the high-tech world; the government commands the company to keep on producing them, thereby wasting resources and causing higher costs and prices.

Most businesses that develop close relationships with vendors or suppliers frequently give preferential treatment to those business

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partners from time to time in order to maintain a good working relationship. Microsoft is prohibited from doing so with the applications side of its business, for Judge Jackson has forbade offering it "terms more favorable than those available" to any other business.

In a fit of egalitarian extremism, the judge further decreed that all computer manufacturers doing business with Microsoft must be offered "equal access to licensing terms; discounts; technical, market, and sales support," etc., etc. Such discrimination, based on merit and performance, is a necessity for any successful business, but Microsoft is banned from it.

The judge's order imposes a huge paperwork burden which will cost the company (and ultimately, consumers) untold millions of dollars and wasted man-hours each year. Every single agreement made between the operating system and applications businesses will have to be reported in detail to the government every three months.

The company is ordered to divert valuable management talent away from producing better computer products by appointing a "Chief Compliance Officer" who will report/genuflect to the government on a regular basis.

A severe system of monitoring is established whereby the government is given "access during office hours to inspect and copy...all books, ledgers, accounts, correspondence, memoranda, source code, and other records and documents." Fat chance that this proprietary information will not make it into the hands of Microsoft's competitors, who urged on the lawsuit, were government witnesses at the trial, and helped write the breakup order that the judge ultimately accepted, which included this very directive.

A particularly creepy and totalitarian aspect of Judge Jackson's order is his encouragement of an internal spying network within the Microsoft Corporation with his admonition to "establish and maintain a means by which employees can report potential violations" of the government's regulations "on a confidential basis."

The source code—perhaps the most valuable asset possessed by Microsoft—will be stolen with the help of the government. Microsoft is required to establish a "secure facility" where virtually all of its business associates will be permitted to "study, interrogate and interact with relevant and necessary portions of the source code." This would be like forcing Coca-Cola to allow other businesses to "study" the secret formula for Coke, effectively ruining its business.

Microsoft is ordered to produce "written reports" about its practices

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whenever the Justice Department lawyers or any of the state attorneys general want one, opening up the door to endless political extortion ("Give us campaign contributions and we won't ask for a report.")

No central planning scheme would be complete without price controls, and the Jackson/Klein scheme is no exception.

The "order" demands "equal access" to discounts offered to computer manufacturers and, after each new product release, Microsoft must "continue for three years after said release to license on the same terms and conditions the previous Windows Operating System Product to any [computer manufacturer] that desires such a license."

The high-technology revolution, led by Bill Gates and Microsoft, has occurred precisely because, up to now, the computer industry has been the least-heavily regulated industry in the world. All that will change dramatically if Judge Jackson's order stands and the higher courts allow Bill Clinton, Janet Reno, and Joel Klein to effectively nationalize the Microsoft Corporation.

The rest of the world, envious of America's economic success (thanks in no little part to companies like Microsoft), must be marveling at such a stupendous act of stupidity and arrogance.

6. Conclusion

In the latest chapter in this saga, Mr. Bill Gates has taken to the airwaves in a series of spots making the "good business" points that computers are important to modern life, that Microsoft has made significant contributions to this industry, that his company will press ahead in the future with even more improvements in consumer welfare, etc. This, it would appear, is part of his answer to the legal difficulties besetting Microsoft.

This is a weak and rather disappointing response. He and his company are being raked over the judicial coals in what can reasonably be characterized as a kangaroo court. Under present law, they can be found guilty no matter what they do. Since this legal process is something of a joke, perhaps it is best to end this paper on that note. Accordingly, consider the following:

Three Soviet prisoners were sitting in a Gulag jail cell comparing stories. The first one said: "I came to work late, and they accused me of cheating the State out of my labor services." The second one said, "I came to work early, and they accused me of brown-nosing." The third one said, "I came to work exactly on time, every day, and they accused me of owning a Western wrist watch."

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But let us not become too blindly enamored of our own system as compared to the of the "Evil Empire." For the joke continues: Three prisoners were sitting in a U.S. jail, found guilty of "economic crimes" and were also comparing stories. The first one said, "I charged higher prices than my competitors, and I was found guilty of profiteering, monopolizing and exploiting consumers." The second one said, "I charged lower prices than my competitors, and I was found guilty of predatory pricing, cutthroat competing and under-charging." The third prisoner said, "I charged the same prices as my competitors, and I was found guilty of collusion, price leadership and cartelization."

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Capital Income Taxation, Labour Supply, and Work Effort

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Although it is well-known that in life cycle models of consumption and labour supply, capital income taxation affects the labour supply through the normal income effect, this interaction may be widespread. Based primarily on graphic tools, three channels through which capital income taxation may affect labour market behaviour, in a manner that it increases labour supply or work effort thereby reducing the distortionary effect caused by a wage tax, are identified: first, capital income taxes alter the lifetime labour supply when workers are constrained on hours of work; second, they affect labour supply in the case where consumers target a certain level of lifetime consumption; finally, they influence work effort in an efficiency wage model. Although the magnitude of these effects must be determined through careful empirical investigations, there are indications that it may be quite significant. Constraints on hours of work affect the majority of the employed labour force and surveys indicate that a large portion of well-to-do baby boomers target consumption rather than maximize lifetime earnings. The large cohort of baby boomers has also accumulated large financial assets for the purpose of purchasing additional leisure through earlier retirement. These financial assets increase the ratio of non-labour income to labour income and may affect the work effort of a large share of the working population.

Key Words: Tax reform, income tax, capital income taxation, labour income taxation, labour supply, work effort

I. Introduction

A decade after the introduction of major tax reforms in Canada and the U.S., tax reform is again taking centre stage in both countries. The proposals advanced so far involve primarily a shift in the relative taxation of capital and labour income. Some proposals, such as the consumption-base flat tax developed by Hall and Rabushka (1995) for the U.S. and its versions for Canada proposed by Grubel (1995) and

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Fortin (1995), involve a shift in factor taxation from capital income to labour income. At the other end of the spectrum, proposals for a move to a comprehensive income base, such as that of Ruggeri and Vincent (1998), involve a reduction in the burden of taxation on labour income through across the board tax rate cuts financed largely by the elimination of tax preferences for that component of capital income which is currently tax-sheltered. The economic implications of the various tax reform proposals depend crucially on the response of those two factors to the changes in their relative levels of taxation. The debate on tax reform, therefore, can be viewed as a debate on the relative economic effects of different factor-specific taxes.

Because of the complexities in the process that generates the economic effects of tax changes, tax policy options have been increasingly analysed through the use of computable general equilibrium models (CGE). These models usually rest on a neoclassical foundation where firms maximize profits and individuals maximize utility by making temporal choices about work and leisure and intertemporal choices about present and future consumption. In this framework, individuals and firms have complete flexibility in their choices and can make marginal adjustments instantaneously. The implications of this approach is that factor specific taxes affect only the factors upon which they are imposed. A recent example of this approach is provided by Devereux and Love (1994) who used a two-sector model of endogenous growth to measure the welfare effects of alternative tax regimes. As they point out explicitly " it is clear that the three types of taxes - consumption taxes, wage taxes and capital taxes - have independent effects"(p. 515).

Life cycle models incorporate changes in economic behaviour during the various stages of an agent's lifespan, but usually treat the retirement decision as a given. Either they fix a certain age of retirement (Fougere and Merette, 1998) or assume that "*individuals...never fully retire.*" (Fullerton and Rogers, 1996, p. 342), although their attachment to the labour force is assumed to decline after they reach a certain age. In reality, workers may not have the flexibility about the work-leisure choice during their working years that is assumed in these models. At the same time they have more flexibility about retirement choices than is assumed in these models.

When the restrictions on labour market behaviour imposed in CGE models are relaxed, the possibility arises for interactions between capital income taxation and labour supply. The possibility that capital

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income taxation may affect labour supply is well recognized in the literature. For example, Feldstein (1974) found that pensions may induce earlier retirement. This result suggests that tax preferences for retirement savings which increase the level of pensions may have negative effects on an individual's lifetime labour supply. Mintz and Wilson (1996) pointed out that "if accumulated savings allow individuals to retire earlier or reduce their effort, then taxes on savings could increase the supply of labour" (p.7).

The Economic Council of Canada (ECC) (1987) identified a channel of interaction through a change in the tax mix within a balanced budget. It argued that the higher tax rates on labour income that must accompany a reduction in captial income taxation "may distort the labour\leisure choice" (p.53). The ECC also pointed out that if lower capital income taxation raises the rate of return on savings, "individuals will be able to accumulate a given stock of wealth faster and may be motivated to increase their labour supply during their youth in order to retire earlier" (p.53). In this paper we identify and analyze three channels through which capital income taxation may affect labour market decisions. First, capital income taxes may alter the lifetime labour supply when workers are constrained with respect to the hours of work while employed. Second, they may affect the lifetime labour supply in the case where individuals target a certain standard of living in terms of lifetime consumption rather than maximizing lifetime consumption. Finally, they influence work effort as modelled in efficiency-wage models. It is suggested that these interactions between capital income taxation and labour market responses may reduce the potential distortions of capital income taxation because increases in the taxation of capital income stimulate the labour supply or work effort at the same time as they reduce incentives to save. The presentation does not incorporate rigorous proofs of the results; instead it relies primarily on graphic tools as a vehicle for highlighting the main channels through which the factors identified above influence the interactions between labour and capital income taxes.

The paper is organized as follows. The implications of constraints on hours of work are analyzed in section II. The case of lifetime consumption targets is evaluated in section III. The interaction between capital income taxation and work effort is discussed in section IV. Finally, section V identifies the major implications of the results for policy analysis and provides some concluding comments.

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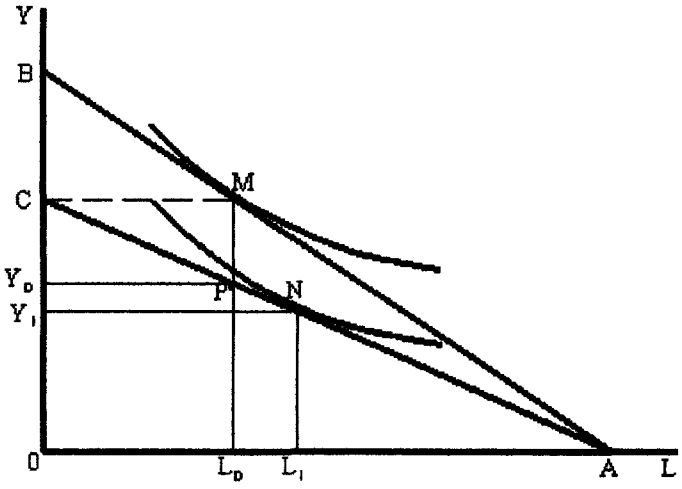
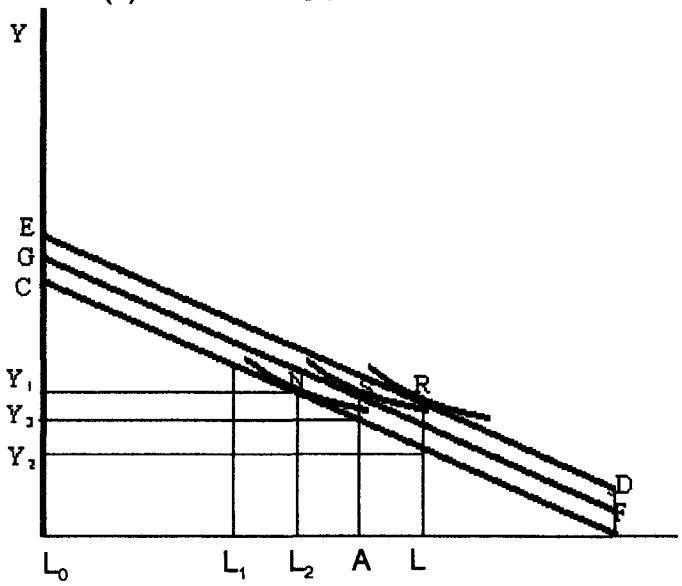
Figure 1 Labour Supply with Hours Constraint



(a) First working period



(b) Second working period

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II. Labour Supply with and without Hours Constraints

In this section we use a standard model of the labour supply in response to changes in wage taxes in order to determine whether and how the labour supply is affected by the inability of workers to reduce hours of work in response to an increase in wage taxes. We assume that the agent receives only employment income and that he tries to maximize lifetime utility. In one case, he can adjust hours of work in each period in response to changes in the after-tax real wage rate. In the other case, the hours of work are fixed in each period of employment, but he can adjust the lifetime number of hours of work by altering the time of exit from the labour force. We also assume that the agent does not make any voluntary savings. This assumption simplifies the analysis without altering the main results. If voluntary savings are included in the cases with and without hours constraints, their income effects will be equal in magnitude and will cancel out when the two cases are compared. Finally, we also assume that the government spends tax revenue to finance exhaustive expenditures which have no effect on private utility, labour supply or work effort.[2]

This standard case is represented graphically in Figure 1, which shows a worker's decision in the first and last period of his working life. In panel (a), the line AB describes the budget line in the initial period before the introduction of taxation. The worker maximizes utility by working AL_0 hours, receiving 0C employment income and enjoying $0L_0$ hours of leisure. When the government introduces a wage tax at the rate BC\B0, the budget line rotates to AC and utility maximization would induce the worker to reallocate L_1L_0 hours from work to leisure, with a corresponding loss of income CY_1. Since the wage tax does not affect the relative price of present and future consumption, the adjustment to hours of work depicted in panel (a) will be reproduced in each period of the worker's employed life and his lifetime labour supply will be reduced accordingly.

In this case, capital income taxation does not interact with the taxation of labour income by altering the latter's effect on labour supply since, by assumption, there are no voluntary savings in each period. Capital income taxation has no effect on the labour supply. This conclusion does not hold when workers are constrained with respect to

[2] This assumption simplifies the analysis by eliminating the income effect that would be generated if the revenue were spent on lump-sum transfers, but does alter the conclusions.

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the hours of work in each period of employment and can only change the lifetime hours of work by adjusting their time of exit from the labour force.

The first working period with hours constraints is depicted in panel (a) of Figure 1. In response to the imposition of the wage tax BC\B0, the worker can no longer move from equilibrium position M to equilibrium position N, but is forced to remain at point P, which now becomes a disequilibrium position.[3] The worker would like to reduce hours of work by L_1L_0; instead, he is forced to give up that desired leisure and is compensated at the after-tax wage rate yielding additional income of Y_0Y_1. This situation can be elucidated by a simple numerical example. Let us consider an individual who, at a wage rate of \$10 before the introduction of taxes, chooses to work 2,000 hours per year. When a tax of 10% is imposed on wages, the individual decides to reduce his hours of work to 1920. Institutional constraints, however, do not allow him to acquire the desired amount of leisure, so he ends up working 2,000 hours at the net hourly wage of \$9. He would have been willing to give up 80 hours worth of leisure per year at this wage rate. The constraint on hours of work has not changed the relative price of leisure and work because it has not affected the \$9 after-tax wage. Therefore, it has not altered the worker's level of desired leisure. It has simply postponed it to the retirement decision when the worker can purchase additional leisure at the price at which he was forced to give it up. However, since future leisure can be acquired by saving the additional income from the monetized leisure produced by the hours constraint, it is now subject to capital income taxation.

When individuals do not value future leisure as much as current leisure and if individuals discount future leisure at the rate of the pre-tax real interest rate r, they will need the entire amount of the accumulated wealth (savings plus interest income) to purchase leisure at retirement time equivalent to the leisure foregone because of hours constraints. This extreme case, in a two-period analysis where the constraint applies only to the first period, is depicted in panel (b) of

[3] This corresponds to the case in which workers have strong preferences for leisure. When workers have strong preferences for work instead of leisure, the wage tax may result an equilibrium to the left of point M (i.e., backward-bending labour supply). In this case, hours constraint will not affect the labour supply through capital income taxation. Therefore our conclusions in this section apply to only the former case.

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Figure 1. In this period the worker's budget line is represented by the line ADE. This line has the same slope as AC in panel (a) because the after-tax wage rate remains unchanged, but the worker now has non-labour income of AD = $Y_0Y_1(1+r)$, i.e. the compensation for the unwanted reduction in leisure in the first period plus the associated interest income. Since the hours constraint does not alter either the relative price of leisure and work or the relative price of present versus future consumption, the amount of income AD will be used to restore the desired balance between work and leisure over the worker's lifetime. In the absence of constraints, the agent would have worked AL_1 hours in each period and received income of OY_1 in both periods. Because of the hours constraint, the agent works AL_0 in the first period, but carries monetized leisure of AD to the last period. He can now obtain labour income of OY_1 in the last period by earning only OY_2 from employment. The equilibrium position is reached at R which is associated with hours of work AL_2.

In terms of our numerical example, the monetized leisure in the first period is worth \$720 and yields \$72 of interest in the second period if r is 10%. The individual who discounts future leisure at a rate of 10% will use the entire \$792 in the second period to purchase 88 hours of leisure which yield the same utility as the 80 hours foregone in the first period. In this case, the hours constraint increases hours of work in the first period, but leads to a lower number of hours of work over the individual's working life.[4]

Adding a tax on capital income reduces the value of monetized leisure during the years of work under hours constraints that is available to purchase leisure in the last period of employment. In terms of panel (b) of Figure 1, this means that non-labour income is reduced to, say, AF. The net result is that the budget line shift downward to AFG, the equilibrium position moves from R to S and the number of hours of work increase to AL_3. In the presence of hours constraints, the taxation of capital income increases the number of hours of work by L_2L_3 compared to the unconstrained case or the constrained case without capital income taxation. By reducing the net income available to purchase deferred leisure, the capital income tax prevents the purchase of the desired amount of leisure, thus resulting in an increase

[4] This is the case as long as the discount rate for leisure that the interest rate are positive.

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in hours of work. In this case, capital income taxes are equivalent to a tax on future leisure which raises the price of leisure with respect to current consumption, thus resulting in a lower amount of leisure purchased. In terms of our numerical example, it is as if the worker gives up leisure at the price of $9 per hour, but has to purchase it at a higher price at the time of retirement. Thus, in the presence of constraints on hours of work, capital income taxation affects the labour supply in opposite directions. It introduces a distortion in the intertemporal allocation of consumption in favour of present consumption, but it also reduces a distortion in the intertemporal allocation of consumption and leisure by reducing the tax advantage of leisure.[5]

III. Labour Supply with Lifetime Consumption Target

We now replace the institutional constraint on hours of work with a constraint imposed by the agent's choice. In this case, agents have complete flexibility to vary their hours of work in each period in response to changes in after-tax wages. However, instead of maximizing consumption over their lifetime they set a target for the standard of living they wish to maintain throughout their life, independently of the source of financing. These agents target a certain level of consumption over their lifetimes. Once that target is achieved, they withdraw from the labour market. Targeting consumption is a variation of the targeting of savings. In either case, the agent chooses to save a portion of his annual income in order to achieve a certain level of wealth, similar to saving for precautionary purposes. Target savers and target consumers differ only with respect to their labour force attachment. The former continue to work after achieving the target level of wealth while the latter retire from gainful employment.

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[5] The interaction between capital income taxation and labour supply is weaker in the case where workers value present and future consumption equally. In this case, they can purchase in the future the full amount of the leisure foregone in the present with the income from the additional hours of work. They may even purchase additional leisure with part of the interest income on the forced saving depending on the strength of the income effect. In this case, capital income taxation reduces the income that can be used to purchase additional leisure, but does not alter the price that the agent must pay to acquire the amount of leisure that he was forced to give up. He can still purchase the desired amount of leisure at $9 per hour because the capital income tax applies only to the interest income. The capital income tax will affect only the portion of leisure that would have been purchased with the interest on the forced saving.

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This case has important implications for public policy for a variety of reasons. First, this type of behaviour may be more widespread than generally believed. According to a survey conducted in 1996 by Royal Trust, 39% of affluent baby-boomers – a fairly large cohort – consider "having enough money to stop working" the highest symbol of success. This group seems not to value wealth accumulation as a goal in itself, but as a means of satisfying a strong preference for leisure. Second, this group, as individuals or in families, earns high incomes and has high saving rates and high level of assets. Finally the type of saving motivated by the attainment of financial independence may not respond positively to changes in rates of return. Empirical studies suggest that saving related to precautionary motives or reasons other than smoothing lifetime consumption is unresponsive to changes in rates of return (See, for example, Carroll (1992), Engen (1994) ans Kennickell and Starr-McCluer (1994)). Target saving or saving aimed at achieving a target level of consumption may even be negatively related to rates of return (Beach, Boadway, and Bruce (1987), pp.74). An increase in the rates of return, for example, through lower capital income taxation or the enrichment of tax-based saving incentives such as RRSPs, will reduce desired savings because it will lower the level of financial assets needed to finance the target consumption and require less annual savings to achieve the lower target. In order to simplify the analysis we have assumed in our analysis that the target level of wealth, and the corresponding rate of saving, is independent of the rate of return and, consequently, of the rate of capital income taxation. In this case, capital income taxation affects only the timing of exit from the labour force and it generates economic effects by altering the lifetime labour supply rather than the rate of saving.

The introduction of a tax on capital income leaves the relative price of leisure and work unaffected. If savings are entirely directed at facilitating early retirement from the labour force and, therefore, are unresponsive to the rate of return, the reduction in the rate of return on the income saved resulting from the capital income extends the number of hours of employment over the agent's lifetime required to achieve the target consumption. Thus if the assumption of consumption target is valid, the response of a large portion of affluent baby-boomers to a reduction in capital income taxes will reduce their lifetime labour supply by advancing the date at which they reach the target wealth level which allows them to quit employment.

Although our analysis is confined to the economic effects of factor

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specific taxes in selected special cases, it may be worth noting that the preferences revealed in the Royal Trust Survey have important implications also for other public policy programs. For taxpayers with consumption targets, programs of tax assistance for retirement saving become counterproductive. These programs deliver the equivalent of a rate reduction in capital income taxes. As pointed out earlier, this type of tax cut may depress rather than stimulate private savings and will speed up the achievement of the target wealth thus permitting earlier retirement than planned in the absence of those programs. In the case of target consumers, public pension plans also become useless. These taxpayers would save voluntarily sums that exceed any requirement of public pensions. In this case, public pensions serve as full offset for private savings and have no effect on the behaviour of this group of agents.[6]

Two additional points are worth stressing. First, there is a major difference between this case and the hours constraint case. In the latter, capital income taxes affect the labour supply through the interaction with labour income taxes in a manner they reduce the distortionary effect caused by a wage tax. In the former, their effects are generated independently and both capital income taxes and labour taxes increase the labour supply with a life-time consumption target. Second, the two channels of influence for the capital income tax may be combined. In fact, the revealed preferences by a large portion of wealthy baby boomers for early retirement from the labour force may be an indication that they may be hours constrained and want to acquire as soon as they can the leisure involuntarily given up.

IV. Work Effort

In the previous two cases, workers respond to changes in wage taxes by adjusting their hours of work, either immediately or in the last period of work. These cases fall into the neo-classical framework where wage flexibility serves as the mechanism for clearing labour markets. Some economists have noted that wages are not so flexible and have proposed various explanations for the observed wage rigidity. These explanations include institutional rigidities, such as minimum wage laws and the power of labour unions, and the notion that lower wages may not benefit a firm if they induce workers' responses that reduce profits

[6] For a detailed evaluation of this issue see W. G. Gale (1995).

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more than wages. In models of wage rigidity known as efficiency wage models, firms are assumed to be concerned not with the level of wages but with hourly wages per effective unit of labour.

Economists have proposed a variety of explanations for the firm's willingness to pay wages above the competitive level (See, for example, Salop (1979), Weiss (1980) and Shapiro and Stiglitz (1984)). In the efficiency wage model developed by Phelps (1994), a major determinant of work effort is the ratio of labour income to non-labour income. In this model, workers' motivation while employed is affected by the income affected while unemployed. The more income a worker can count on while unemployed - from government transfers, returns on assets or support from family members - the lower is his work effort because non-labour income reduces the cost of being unemployed. In Phelp's model, the constraints on the hours of work are not relevant for the worker's behaviour because his choice is between working at the same job or being unemployed while looking for another job. Capital income taxation does affect labour market behaviour, as in the neoclassical model with constraints, but it operates through a different channel.

When income from savings is not taxed and a tax rate t is imposed on labour income and unemployment benefits, Phelp's work effort function can be approximated by [7]

$$e = \left[\frac{w(1-t)+m}{upw(1-t)+(1-u)w'(1-t)+m} \right]^{\sigma} \tag{1}$$

where e is work effort, w is pre-tax labour income, p is the replacement rate from unemployment compensation, u is the unemployment rate, w' is the wage rate with another firm, m is other non-labour income (including income from capital) before tax, and σ is the elasticity of work effort with respect to the ratio of income while attached to this firm to expected income if laid off.

The increase in the wage tax rate t reduces the return to work effort in the current job or in an alternative job; it will also reduce net income from unemployment if the replacement rate is based on after-tax wages or if the benefit is treated as a wage replacement and is taxed as wages (the case shown in expression 1). Under these conditions, for a worker without non-labour income ($m=0$), the increase in wage taxes

[7] See Marchildom, Sargent and Ruggeri (1996) for more elaborations of the model.

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would reduce both the return to labour and the income while unemployed by the same proportion, therefore, it would have no effect on work effort.

For a worker with positive non-labour income ($m>0$), it can be shown from expression (1) that $\partial e/\partial t<0$ and $\partial e/\partial m<0$ when $w/w'>(1-u)/(1-up)>1$. Thus, the wage tax increase will reduce work effort while a tax on capital income which reduces m will increase work effort. This result is similar to that in the neoclassical model, constrained or unconstrained, except that in the latter the adjustment is made in the number of hours worked, either immediately or postponed. In the neoclassical model, there is no increase in unemployment, because of the flexibility of wages, but there are negative effects from the reduction in labour supply. In Phelp's model there is an increase in effective labour costs, a reduction in the demand for labour and higher structural unemployment.

When capital income is taxed at the same rate as labour income, Phelp's work effort expression becomes

$$e=\left[\frac{w(1-t)+m(1-t)}{upw(1-t)+(1-u)w'(1-t)+m(1-t)}\right]^{\sigma} \qquad 2)$$

It is evident that imposing an income tax at the same rate on labour and capital income leaves expression (2) unchanged and, therefore, has no effect on work effort. This is because the income tax does not alter the ratio of labour to non-labour income. In Phelp's efficiency wage model, the tax on capital income neutralizes the potentially negative effect of the wage tax on work effort. Therefore, it generates efficiency effects in opposite directions: it distorts the saving decision, by changing the relative price of present versus future consumption, but it eliminates the distortion of the wage tax by restoring the ratio of labour to non-labour income.

This result parallels that in the constrained neo-classical model. In Phelp's model, an increase in the rate of a comprehensive income tax (wage tax plus capital income tax) is neutral with respect to work effort. In the neo-classical model, the addition of a capital income tax to a wage tax in the presence of constraints on hours of work, or targeted consumption, reduces the potential negative effects of the wage tax on labour supply.

V. Implications

The interaction between capital income taxation and labour market

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behaviour analysed in the previous two sections has important implications for tax policy analysis and the evaluation of alternative tax policy options.

1. Labour Market Structure

The foregoing discussion suggests that capital income taxes may affect the labour supply and that the magnitude of that effect depends partly on the strength of constraints on hours of work. These constraint are least effective for the self-employed, contract workers and low-wage workers with unstable employment. They are more binding for permanent employees, especially those employed in the public sector.

These differences suggest that empirical studies should uncover higher labour supply elasticities for the self-employed than for permanent employees. These are the results derived recently by Showalter (1995). In his analysis of the labour supply response of managers to income tax changes, Showalter estimated a labour supply elasticity of .18 for high-income self-employed managers. However, he found a zero elasticity for high-income managers employed in the private sector and a negative elasticity for high-income government managers. Showalter concluded that "particular work arrangements might be important for estimating labour supply elasticity." Our analytical results suggests that, over the lifetime, it is not just work arrangements and flexibility with respect to hours of work that affect labour supply responses to wage taxes, but also their interaction with capital income taxes.

Quantitatively more significant may be the preference for early retirement by wealthy baby boomers. This cohort is large, has high income and saving rates, possesses substantial financial assets and embodies considerable amounts of human capital largely acquired at highly subsidized prices. Policies that affect their attachment to the labour force may have potentially large effects on employment, output and social welfare.

2. Tax Policy Analysis

The economic effects of changes in the tax structure are increasingly being analysed with the help of computable general equilibrium (CGE) models. In these models, the entire labour force is often represented by a single worker, only the labour supply response is taken into consideration and this response is approximated by an average labour supply elasticity which is assumed to be equal for all

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workers [see, for example, Ballard, Shoven and Whalley (1985)]. This approximation does not portray realistically the labour market because it is well-known that labour supply elasticities differ by age, sex and occupation [see Killingsworth (1983) and Phipps (1993)]. CGE simulations performed by Souissi, Vincent, Ruggeri and Beausejour (1997) have shown that, for certain tax changes such a move from a multiple-rate to a single rate tax, the bias in the estimated efficiency effects using a single labour supply elasticity may be fairly large. The analysis developed in this paper suggests that this bias may be even larger when we include the interaction between capital income taxes and the labour response of different workers.[8]

It may be argued that, if the labour market effects of capital income taxation are confined to income effects, they are not relevant in the comparison of different policies in efficiency terms. This argument is weakened by a number of factors. First, income effects may have important policy implications. Economists evaluate the economic viability of government spending programs by comparing the benefits they are expected to generate with the costs of raising the necessary funds. This cost, commonly known as marginal cost of public funds (MCPF), includes the amount of tax paid and the loss of utility from tax-induced behavioural changes. The higher is the value of the MCPF, the higher must be the benefits of a government program to justify its introduction. As pointed out by Ballard (1990), in this type of analysis "income effects are important, and efficiency calculations depend chiefly on uncompensated elasticities."(p. 263). The inclusion of income effects tends to reduce the estimated value of MCPF thus making viable government spending programs that may be found uneconomic if these effects are ignored. Second, if workers adjust their work effort instead of their hours of work, policy changes that reduce work effort will generate efficiency effects because they will increase the level of structural employment by raising effective wages. Finally, any policy that reduces lifetime hours of work will also reduce the return on human capital. If human capital was acquired at a subsidized price because it was expected to generate spillover benefits to society, the reduced utilization of this human capital will reduce its social benefits

[8] This interaction is not captured by partial equilibrium analysis or static CGE models. Therefore, when interpreting estimates of the economic effects of different tax changes derived through those models it must be kept in mind that the results may incorporate potentially large biases.

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thus generating a social loss.

3. Tax Reform

As mentioned in the introduction, proposals for tax reform involve a move to a flat-rate consumption-base tax at one end of the spectrum and a shift to a comprehensive income base at the other end. The first set of proposals involve a shift of tax burdens from capital income to labour income while the second set would reduce the taxation of labour income relative to capital income.

Consumption-base flat taxes have been defended primarily on the expectation that they will stimulate domestic savings and investment, thus raising economic growth and improving living standards. Our analysis suggests that, to the extent that there are agents whose behaviour conforms with the assumptions in the three cases evaluated in this paper, the expected economic gains may not fully materialize. The higher tax burden on labour income will reduce the labour supply by making leisure more attractive, savings will not increase as expected if there are agents whose savings are unresponsive to changes in the rate of return, such as those with saving or consumption targets, there may be additional negative effects on labour supply if agents are constrained with respect to hours of work or set consumption targets and there may be negative efficiency effects through reduction in work effort and lower utilization of human capital.

The same conditions will tend to reduce the potential efficiency losses from a move to a comprehensive income base associated with revenue-neutral across the board cuts in statutory rates. The reduction in the relative taxation of labour income will stimulate labour supply and work effort. This effect will be magnified by the increase in the relative taxation of capital income for agents with the behaviour patterns described in this paper. At the same time, the negative effects of the increase in the relative taxation of capital income would be mitigated by the existence of agents with lifetime consumption targets.

4. Conclusions

This paper identified three channels through which capital income taxation may affect labour market decisions and their implications for tax policy analysis. The first case involved a constraint on hours of work within a neo-classical framework. The second case assumed that agents have a lifetime consumption target. The last case involved an efficiency

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wage model developed by Phelps (1994).

The analysis shows that while capital income taxes increase the labour supply or work effort thereby reducing the distortionary effect caused by a wage tax in cases 1 and 3, both laobur and capital income taxation increase the labour supply in case 2. It should be pointed out that each case argued in this paper is a separate scenario under a separate assumption. No attempt has been made to bring all three together. The magnitude of the economic effects of the capital income taxation interactions identified in these cases should be determined through careful empirical investigations. However, there are indications that the effects may be quite significant. Constraints on hours of work affect the majority of the employed labour force and surveys indicate that a large portion of well-to-do baby boomers target consumption rather than maximize lifetime earnings. The large cohort of baby boomers has also accumulated large financial assets for the purpose of purchasing additional leisure through earlier retirement. These financial assets increase the ratio of non-labour income to labour income and may affect their effort of a large share of the working population. Our results indicate that the efficiency costs of capital income taxation may be lower then previously thought due to the positive spillover effect to the labour market.

Acknowledgment: We would like to thank Vaughan Dickson, David Murrell and Larry Levine for their helpful comments.

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BOOK REVIEW ARTICLE

Yes! There are Limits to Arbitrage: Lessons from the Collapse of Long Term Capital Management

Edward A. Miller[1]
University of New Orleans

Key Words: Long Term Capital Management, hedge funds, arbitrage, leverage, New York Federal Reserve

Inventing Money: The Story of Long Term Capital Management and the Legends Behind It
Nicholas Dunbar
John Wiley & Sons, 2000

Long Term Capital Management was an extremely large hedge fund whose potential collapse threatened the stability of the world financial system before it was saved by a Federal Reserve-orchestrated rescue. The legends behind this limited partnership are the people who created it. These include fabled Salomon bond trader John Meriwether and two Nobel Prize winners, Myron Scholes and Merton Miller. The first part of the book manages to tell the story of the founders. In the course of this story, it covers topics such as the emergence of modern option theory (a problem both Miller and Scholes had worked on), arbitrage arguments in theoretical finance, and arbitrage as a business.

Probably the most valuable part of the book is the insight it gives into the sophisticated arbitrage business. In textbook theory all packages of securities that provide the same payoffs should provide the same returns. If they do not, arbitrageurs would be able to construct "money machines" that provide a risk-free return. In practice, the price of various assets is set by supply and demand in different markets, and prices do not meet the no-arbitrage conditions. This creates profit opportunities for arbitrage firms. Long Term Capital Management was

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the largest of such firms, and its history provides an insight into this aspect of the financial markets. Some may read the book merely for the story of the personalities and the firm, but for financial economists the greatest value is probably in the account of the strategies the LTCM and similar firms followed (the stories of other similar operations are worked in).

What are some of these? Meriwether, the ex-Salomon Brothers bond trader who founded LTCM, had made much money in Treasury trades that exploited the fact that new Treasury bonds when issued ("on-the run bonds") were actively traded and more liquid than the more seasoned bonds ("off-the-run"). This caused them to sell at higher prices than other Treasury bonds with almost the same maturity. Later, when the newly issued Treasury bonds had been around a while and were "seasoned" they would trade at prices similar to those of the older Treasuries. By selling (shorting) the new bonds and buying seasoned ones, an arbitrage profit could be earned when the new bonds came to be priced on the same basis as the older ones. Meriwether put the new firm into the business of making such trades.

Another successful business was issuing long-term options on European indices. European banks had found that customers desired investments that guaranteed them at least the money they had paid for an investment, but which gave them the upside potential of stocks. Such "structured" products are possible by buying a zero-coupon bond that pays off the guaranteed principal plus a long-term option. LTCM became a leader in the business of providing such options, and figured out ways to hedge their own exposures. Later, the problem of maintaining the capital required to mark these options to market was to help bring the firm down.

There are accounts of very complex deals that involved trying to profit from the addition of Italy to the European Monetary Union. This meant that the much higher Italian interest rates would fall to the general European level. Then there were discrepancies in the structure of the term premium on swaps in Germany versus Great Britain. One problem Dunbar had in writing this book was the need to explain the various complex financial instruments used (such as swaps) as he goes. Generally, he does a good job of this, although it does delay the narrative some in the earlier chapters.

What brought LTCM down? The firm was built on the idea that there were discrepancies in the prices for various assets in the market such that it was possible to build hedged positions that essentially

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guaranteed a profit. If one asset in the position went up, another would normally go down. Thus risk was reduced, and ideally, eliminated. Eventually, discrepancies in prices would disappear, and the firm would earn a profit. To make such arbitraging of small differences sufficiently profitable it was necessary to have incredibly large amounts of capital. Fortunately, such capital could be raised. The founders of the firm included two Nobel Prize winners (Miller and Scholes), Meriwether, who had made a fortune in bond trading at Salomon Brothers, and ex-associates of his from Salomon Brothers. With such distinguished founders the fund was able to start business in 1994 with over a billion dollars in investor capital.

The book is partially the founders' stories. These should interest those concerned with either the history of modern financial theory or with Wall Street. Much space is devoted to Meriwether's bond trading at Salomon Brothers. This operation brought Salomon Brothers down through violating a Federal Reserve Board rule that limited any firm to only 35% of the bonds sold at one auction.

The fund was organized under the laws of the Cayman Islands for regulatory and tax reasons. The actual management of the portfolio was done by Long Term Capital Management. This was organized as a limited partnership and operated from Greenwich, Connecticut. LTCM was to receive annually 2% of the capital as a management fee, and 25% of the profits. Investors had to put up a minimum of $10 million and could not withdraw their funds for at least three years. Such a vast pool of capital had the potential for making the seven principals incredibly rich. It also had the potential for destroying them, since many of the partners put most of their personal capital into the venture. Initially, LTCM was highly profitable and the equity capital grew to 4.87 billion dollars by 1998.

However, the reason LTCM is a fit subject for books is its use of leverage. The last publicly-available balance sheet for the portfolio showed total liabilities of $124.5 billion. This, along with the equity, made total assets $129 billion. However, the really remarkable part was in off-balance sheet items. Total derivative positions had a notational value of $1.25 trillion. This is an incredible sum to be controlled by a small partnership that few had even heard of.

How was such leverage possible? Those trading with LTCM were unaware of how leveraged it was. As is customary for hedge funds, LTCM kept secret the nature of its positions. Others might have duplicated its strategies if its positions were known. Each of the parties

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dealing with it knew merely it was very large and had very prestigious and experienced people running it. They did not view the trades made with it as particularly risky.

Finance textbooks have long presumed that essentially infinite leverage was possible if the proceeds of a short sale were used to take offsetting long positions. LTCM came closer to realizing the theory than many of its critics, including myself, had realized was practical. Most of the assets and liabilities were in the form of fully collateralized positions in which short positions had collateral pledged against them. The use of off-balance-sheet fixed income swaps in which one firm exchanges the payments from one set of bonds for the payments from another set of bonds (such as fixed-interest payments for floating-rate payments) further added to the leverage.

Normally when a short sale is made the firm lending the securities receives a security payment equal to the proceeds of the sale. The value of the position is marked to market each day so that if the security rises in price the lender of the security is protected. In addition, there is usually a little bit of extra security, perhaps 2%, sometimes referred to as a "haircut". Thus, if the borrower of the security is unable to meet a market call the lender is still secured. LTCM had enough clout (as did some other very large hedge funds) to avoid having to put up this extra security. Presumably, the other parties thought LTCM was large enough and diversified enough that it would always be able to meet its obligations. Trusting it, they did not require actual proof of this proposition.

Paradoxically, these relatively generous terms were one of the factors that brought the firm down. Once massive losses were experienced, the counterparties to trades began to have doubts about their security and naturally were concerned. On the long-term options the firm had issued, the counterparties had the privilege of deciding what the mark-to-market requirements were. This was because reliable market quotes were scarce. Naturally, when LTCM began to appear shaky, the counterparties used this flexibility to choose valuations that required more capital be put up. This reduced the capital available for other purposes, contributing to the collapse.

Paradoxically, shortly before the collapse (i.e., in December 1997), the management was so confident that it returned $2.7 billion to its investors. The partners felt that the remaining capital ($4.7 billion) was adequate to finance the profitable opportunities they had identified. Returning this capital raised the returns to the remaining investors

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(which included the principals). This increased the leverage from 18.3 to 27.7.

LTCM, like its competitors, had risk-control procedures in place. They used a method called Value-at-Risk, which attempted to estimate how much the firm had exposed to various trades. If loses exceeded a pre-set limit, the firm was to reduce its positions. This procedure was actually required by regulators for big banks, which were the competitors of LTCM. However, LTCM was itself unregulated (a result of being a non-bank Cayman Island organization). Their Risk Aggregator model (which allowed for the correlations between different risks they were exposed to) said they would lose no more than $339 million (10% of capital) in ninety-nine out of a hundred months. However, such models often fail adequately to consider risks that are not in the recent historical record (which is where the relevant statistics come from).

In May and June of 1998, LTCM lost money and breached its Value-at-Risk measures. LTCM management blamed this on a competitor shutting down its bond arbitrage operation. Salomon had been engaging in trades similar to those of LTCM, and it was plausible that their attempts to unwind their positions would move markets against LTCM. This could be interpreted as a one-time unfavorable event. However, this large loss led to a decision to reduce LTCM's positions. This was only a few months after the decision to return capital to the investors.

The issue then became which positions to cut back. One possibility was a proportionate reduction. This would mean exiting some rather illiquid positions and taking some losses. Instead, the decision was to exit from the most liquid positions. This kept the firm in what it considered to be the most profitable trades. However, it also meant that later when the firm experienced further losses it had few liquid positions it could sell off to further reduce its exposure.

The final crisis came when Russia defaulted on her debts. While a default had been expected, Russia unexpectedly forbid its banks to honor foreign exchange contracts for a month. This created large losses for many foreign banks, and caused the bankruptcy of one large hedge fund, the High-Risk Opportunities Fund. While LTCM took some losses on Russia, most of the damage was indirect. Other banks and traders did not know who was solvent and who was in trouble. The risk managers in firms administering their Value-at-Risk systems required their firms to reduce exposures. Looking for positions to get out of,

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banks and hedge funds sold their positions in the more liquid swap and government bond markets. This general liquidation lowered prices in these markets, causing the typical bank or hedge fund to experience further losses. This produced yet another wave of liquidations as risk-management systems required further reductions in positions.

Thus, in aggregate, the risk management systems contributed to the very problem they were intended to solve. The basic problem was that the theory presumed that markets would be liquid and that one could offload positions onto other parties at near-prevailing prices if circumstances made it necessary. Yet, since a buyer is needed for every seller, all investors cannot sell at the same time. The problem is similar to one that helped produce the 1987 crash (this episode is discussed in Miller 2000). Then, practitioners of modern financial theory had developed the idea of portfolio insurance, which depended on being able to sell in time to limit losses to acceptable amounts. However, when large sums of money were managed in this way, everyone could not sell at the same time.

Thus, in August of 1998 the large pools of money that had been trying to exploit discrepancies between the prices of related securities were all trying to reduce their positions at the same time. Since it was the trading by the large pools of capital that had been keeping the price discrepancies from being even larger, the cessation and unwinding of their arbitrage activities resulted in the discrepancies getting larger, and most of the funds experiencing losses.

There was a general search for safety and liquidity, with the prices of the liquid securities being bid up. Many of the LTCM trades had involved being short the more liquid securities and buying equivalent less liquid securities. This caused widespread losses for LTCM in trades that at first would not appear to have anything much to do with each other.

By August it became clear that additional capital was needed and frantic efforts were made to find it. However, it was too late and investors who at the beginning of the year (when LTCM still had an impressive record) would jump to invest were no longer willing. August brought the firm a loss of $1.85 billion. Once the magnitude of the losses became known, others who had traded with them were naturally concerned and used their ability (mentioned above) to mark positions to market to make themselves more secure.

Because the LTCM portfolio was located in the Cayman Islands whose laws (unlike those in the U.S.) did not provide for immediate

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liquidation of positions in the event of bankruptcy, parties that had the opposite positions to LTCM could have their positions tied up for months while a bankruptcy was conducted. The counterparties included many of the world's large financial institutions whose finances would be adversely affected. This made them willing to consider a takeover.

The New York Federal Reserve got involved because of the risk to the stability of the financial system, and brokered an arrangement in which a consortium of large banks and financial institution refinanced LTCM.

Naturally, there can be debate about whether the Federal Reserve should get involved in saving private firms and pressuring other firms into participating in a rescue. This book reveals it was probably unnecessary. At the last moment, Goldman-Sachs had negotiated a deal where Warren Buffet would finance a take-over, buying the existing investors out for $250 million and then, with others, putting an additional $4 billion into the fund, with Goldman-Sachs traders taking over management of the fund. Meriwether and the founders would lose both their jobs and the bulk of the money they had put into creating LTCM (they held about 40% of the equity). However, Meriwether declined this offer, claiming he lacked the legal authority to accept.

Dunbar argues that he knew that once the Federal Reserve had gotten publicly involved it had to produce a deal and avoid a collapse of LTCM. Thus, Meriwether could reject this deal and expect that a better offer would emerge (aided by Federal Reserve pressure). The Federal Reserve brokered an arrangement in which a consortium of large banks and financial institution put $3.625 billion into the firm. The original investors retained their stake (now worth about $400 million, appreciably more than the rejected buyout offer), although it would now be only about 10% of the portfolio. A committee of the new investors was given control, although Meriwether and other former principals retained jobs (at $250,000 per year). Thus, the Federal Reserve intervention may not have been necessary to prevent a sudden collapse of LTCM. Instead, the chief effect was to reduce the financial loss to the original investors, including those who made the decisions to take on the risks that eventually failed.

What are the lessons for financial theory? One appears to be that risk-free financial arbitrage isn't really possible. There is always credit risk. Trades that depend on markets remaining and pricing discrepancies shrinking to zero over time are exposed to the risk that the discrepancies will instead become bigger at some point, making it

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impossible to maintain the positions. This is a real obstacle to arbitrage. Indeed, Shleifer (2000) uses LTCM experience to support his argument that there are limits to the ability of arbitrage to prevent mispricing of securities.

Also investments that in ordinary time appear to be diversified (being in different countries or in types of securities) may become correlated if there is a flight to safety. Even if a position has been constructed that appears to lock in a profit, it is necessary to have adequate capital to maintain the positions, because the mispricing being exploited may get worse before it moves in the anticipated direction.

It also raises again a question about the traditional hedge fund incentive structure, where the managers get a base fee (2% of assets for LTCM), plus a share of the profits (25% for LTCM). Fund managers can do extremely well if the fund succeeds. In the good years, LTCM profits exceeded a billion dollars. If the fund fails, the investors take the loss, not the fund itself. This is a structure that encourages the taking of large risks. Bets that most likely will pay off with modest profits (as a percentage of the sums invested, which can be large in absolute dollars), but that have a small chance of very large losses will be encouraged. The LTCM story could have easily turned out differently with the principals becoming extremely rich.

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The Impact of Lawlessness on Pakistan's Economic Performance 1960-95

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The authors demonstrate the relation between periods of heightened lawlessness in Pakistan between the years 1960 and 1995, and variations in economic performance.

Key Words: Pakistan, Gross National Product, lawlessness, corruption.

I. Introduction

It may be readily conceived that the socioeconomic impact of lawlessness in a society, whether arising from corruption in the public and private sectors, perversion of rules and procedures, abuse of power, crime including white-collar crime, almost invariably has negative microeconomic and macroeconomic effects on economic performance. Since its birth in 1947, Pakistan has suffered to a lesser or greater extent from lawlessness, causing one British journalist, E. Duncan, to observe in 1989 that:

> Lawlessness goes all through society. The robberies, kidnappings and riots are the extreme fringes of it; but people do not much obey the traffic laws or tax laws either.... There are too many people around the ladder of power who are cheating..... A minister of the Sindh provincial government was robbed at Heathrow (London airport) of a brief case containing fifty million rupees in cash. He did not report it to the police. ... Politicians have political

[1] This paper is based on research by the senior author for his doctorate, recently completed at the University of the Punjab, Lahore. S.M. Ghazanfar is Professor and Chair, Department of Economics, University of Idaho, Moscow, Idaho (USA); and Rafiq Ahmad is Professor Emeritus (Economics), and former Vice Chancellor, University of the Punjab, Lahore, Pakistan; both served on the senior author's committee.

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> opponents harassed, jailed and tortured. Civil servants are told to fiddle election results. .... The police will produce a spurious charge, the magistrate will sign the order of continued detention every time it comes up .... It looks nice on paper, but nobody is fooled (Duncan, 35-36).

But how closely do variations in the state of lawlessness harm the prosperity of the country as a whole, as measured by the Gross National Product? We hear propose to offer some preliminary evidence as to the impact of lawlessness on Pakistan's general economic performance during the period 1960-1994.

It is generally held that in modern societies the public sector exists to pursue several functions, some of which are part of the classical economics elaborated in detail by Adam Smith in his *The Wealth of Nations* (1776). First, "the duty of protecting the society from the violence and invasion of other independent societies; secondly, the duty of protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it, or the duty of establishing an exact administration of justice; and thirdly, the duty of erecting and maintaining certain public works and certain public institutions..." (Quoted in Ashley, 1894, p.122). Reference here is not only to external defense, but also to the maintenance of a level of internal law and order which will not only provide security for the public, but will also ensure suitable conditions necessary to permit socioeconomic progress (something that Joseph Schumpeter described as an appropriate "social climate" for general progress) and the development of an adequate socioeconomic infrastructure. Indeed, the eminent late-medieval Muslim scholar, Ibn Khaldun (1332-1404), writing in the fourteenth century placed particular emphasis on the need for internal law and order as a prerequisite for national progress, as have numerous more recent scholars (see, for example, Spengler 1949, Rostow 1878, North 1991, Streeten 1995). Additional functions that are typically undertaken by contemporary governments, are emergency economic measures in response to "market failures" and efforts to maintain macroeconomic stability. Thus in addition to controlling internal crime and ensuring safety against external aggression, modern governments generally seek to protect and encourage the development of the socioeconomic infrastructure. With the prevailing atmosphere of riots, kidnappings, and hold-ups in Pakistan the task of creating confidence among investors and citizens

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Figure 1

Pakistan's Economic Performance: Comparative Statistics for Key Indicators, Selected Periods, 1960-68 and 1970-77

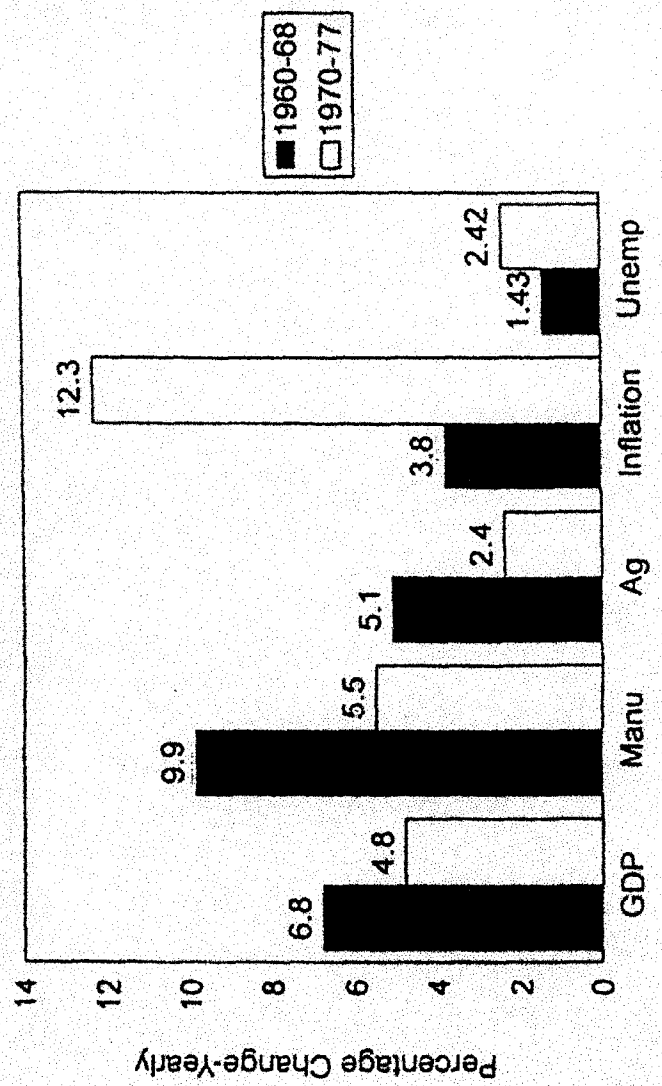

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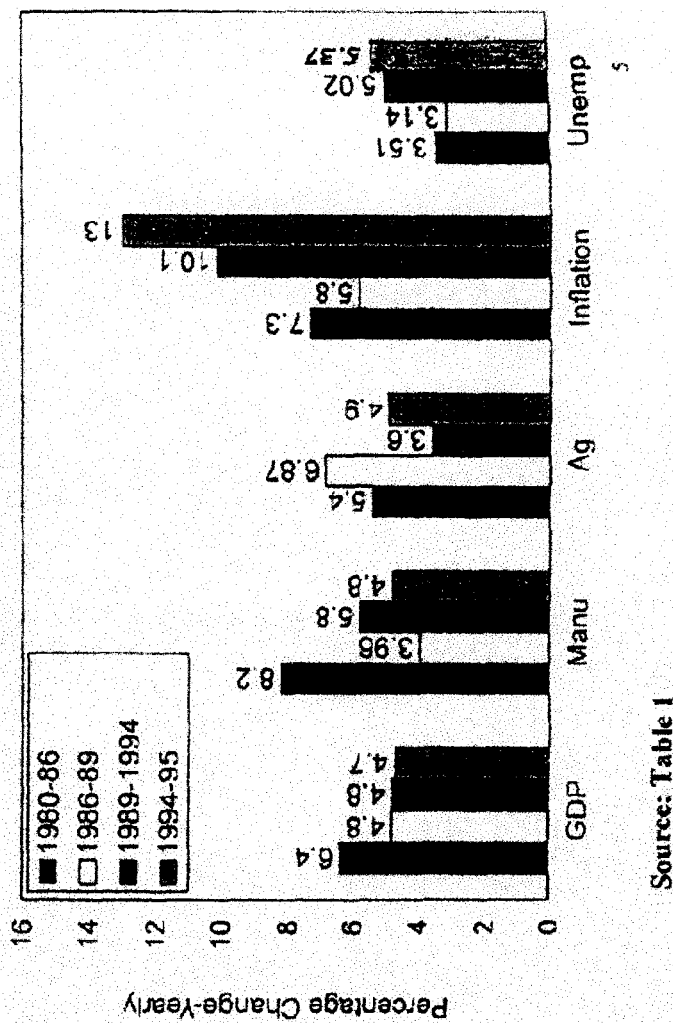
Figure 2

Pakistan's Economic Performance: Comparative Statistics for Key Indicators, Selected Periods, 1980-95



Source: Table 1

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Table I – Pakistan's Economic Performance: Some Major Indicators (1960s to 1993-94)

Year	Growth Rates of			Rate of Inflation	Unemployment	Unemployment Rates	Labour Force
	GDP	Manufacturing	Agriculture		(In Million)	(In Million)	(In Million)
1960s	6.8	9.9	5.1	3.8	0.25	1.43	17.20
1970s	4.8	5.5	2.4	12.3	0.54	2.42	21.50
1980s	6.4	8.2	5.4	7.3	1.00	3.51	28.45
1980-81	6.4	10.6	3.7	13.9	0.95	3.70	25.65
1981-82	7.6	13.7	4.7	11.1	1.00	3.81	26.27
1982-83	6.8	7.0	4.4	4.7	1.06	3.91	26.91
1983-84	4.0	7.9	-4.8	7.3	1.05	3.82	27.45
1984-85	8.7	8.1	10.9	5.7	1.04	3.71	28.00
1985-86	6.4	7.5	6.0	4.4	1.02	3.64	28.05
1986-87	5.8	7.5	3.2	3.6	0.90	3.04	29.60
1987-88	6.4	10.0	2.7	6.3	0.94	3.14	29.93
1980/81-87/88	6.5	9.0	3.9	7.1	1.00	3.60	27.73
1988-89	4.8	4.0	6.9	10.4	0.97	3.14	30.87
1989-90	4.6	5.7	3.0	6.0	1.00	3.14	31.82
1990-91	5.6	6.2	5.0	12.7	2.00	6.28	31.83
1991-92	7.7	8.1	9.5	9.6	1.93	8.85	32.97
1992-93	2.3	5.4	-5.3	10.6	1.99	5.85	33.97
1993-94	4.0	5.6	2.6	11.2	2.05	5.85	34.98
1988/89-1993-94	4.8	5.8	3.6	10.1	1.66	5.02	32.7

(Source: Pakistan Economic Survey 1994-95)

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Table 2 –Pakistan's Economic Performance: Major Indicators
Consolidated Summary Statistics, 1960 to 1995

Economic Indicators	1960s (up to 1968)	1970s (up to 1977)	1980-86	1986-89	1989-94	1994-95
GDP	6.8	4.8	6.4	4.8	4.8	4.7
Manufacturing	9.9	5.5	8.2	3.96	5.8	4.8
Agriculture	5.1	2.4	5.4	6.87	3.6	4.9
Inflation	3.8	12.3	7.3	5.8	10.1	13.0
Unemployment	1.43	2.42	3.51	3.14	5.02	5.4

Source: Consolidated statistics developed in Table 1.

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has assumed the foremost importance. While other Governmental roles continue to be equally vital, the provision of security to those engaged in nation-building economic activities has become the first priority of law enforcement authorities in many developing countries.

The basic thrust of recent governmental policies is to open the Pakistan economy to private and domestic investors with a view to accelerating the pace of industrialization, but efforts to improve economic conditions in Pakistan are unlikely to be successful for so long as the country is plagued by a climate of corruption, abductions and robberies, particularly in the areas which have the most potential for an economic take-off.

The factors which determine where and when investors will feel comfortable are many but foremost is the presence of a secure and safe domestic environment. Pakistan's economy has repeatedly suffered serious setbacks due to lawlessness, and the breakdown of law and order during late 1960s was accompanied by a decline in the annual growth rate to 1.4 percent, compared to an average 5.5 percent annual increase during early 1960s. A more recent case is that of the Sindh province where development has almost come to a halt because of ethnic riots and widespread occurrences of kidnapping.

A recent publication by the British organization known as Control Risks Group Limited classified countries according to international security risks and rated Pakistan, Algeria, Burma, Cambodia and Burundi as high-risk countries for business. This British consultancy group, which advises businesses on investment risks in volatile countries, rates Pakistan as high risk particularly on account of the persistent danger of ethnic riots and street violence. Burma, though rated as high risk, is projected as having prospects for improvement after the release of Aung Sun Su Kyi. Control Group Risks Limited defined countries as high risk areas if conditions verged on war or civil uprisings, if breakdown of law and order was an imminent danger, or if there was a sustained campaign specifically directed against the personnel and property of foreign enterprises (Survey Report, 1995).

II. Lawlessness and Macroeconomic Performance

In attempting to demonstrate the socioeconomic costs of general lawlessness, we propose to examine the performance of Pakistan's economy in historical perspective, matching trends in law and order against corresponding macro-economic indicators.

Our observations are based on the background of data provided

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in Table 1. Table 2 provides the same data in a summarized form; and for ease of interpretation and scrutiny, these data are displayed in Figures 1 and 2, which show the performance of the economy for the period 1960-68 to 1970-77 and 1980-1995, respectively. The economic indicators utilized here are the rate of growth of the gross domestic product, of the manufacturing and agricultural sectors, and rates of inflation and unemployment.

Along with evidence of variable economic performance during certain years over the period of 1950 to mid-1990s, we note the state of law and order during the corresponding years over the entire period. While the present effort does not necessarily demonstrate a direct causal link between lawlessness and lack of order in the nation and the poor performance of the economy, the fact that such developments seem to more or less coincide, with some leads or lags, provides some credence to causation. More detailed research is currently underway in an attempt to identify causation with greater precision.

(a) Early Decades (the 1950s and 1960s)

Following Pakistan's independence, a basic framework of economic development emerged with the development an appropriate administrative structure and certain government-sponsored economic endeavors such as the Five-Year Plans. This process continued during the decade of the 1960s. The rate of investment (the ratio of gross domestic investment to gross domestic product, GDP) increased from 14.4 percent in 1959-60 to 24.5 percent in 1964-65, but declined somewhat during 1965-70 due to a reduction in foreign assistance. The resultant average annual growth in real GDP, manufacturing and agricultural, ranged between 6.8 percent, 9.9 percent and 5.1 percent, respectively, during the 1960s, and the labor force grew at a moderate annual rate of around 2.0 percent. Coupled with low a inflation rate (3.8 percent) and high growth rates in major labor-absorbing sectors (agriculture and manufacturing, which together employed about 72.7 percent of the labor force) on the one hand, and a moderate growth of the labor force on the other, the open unemployment rate remained at a very low level (1.43 percent) during the 1960s.

The earliest part of the decade was one of consolidation, political stability, and relatively low level of lawlessness, a significant contributing factor being the imposition of martial law in 1958 under General Mohammad Ayub Khan, which continued until 1962. During the mid-1960s, political-social turmoil emerged, particularly in East

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Pakistan. Thus, political turmoil in the late 1960s coincided with a slow down in industrial activity which eventually contributed to a rise in unemployment, particularly among educated youth.

(b) The Decade of the 1970s

Any optimism raised by the impressive performance of the economy during the 1960s was frustrated by the experience of the early 1970s. Massive and protracted political disturbances in the late 1960s led to a third period of martial law commencing in 1969, under General Yahya Khan. During this period, the East vs. West Pakistan controversies heightened to the point that a civil war in East Pakistan emerged, leading eventually to the separation of the East Pakistan as an independent Bangladesh in 1971 following the invasion by India in support of the East Pakistani insurrection.

Following a cessation of the conflict with India in 1972, reforms introduced by the government of Zulfikar Ali Bhutto between 1972-77 added a major element of uncertainty in the business-economic climate which could not be removed by subsequent assurances. Nationalization of a significant segment of the manufacturing industries and the entire financial system shattered the confidence of potential investors, domestic as well as foreign. Furthermore, the adverse weather conditions negatively affected agricultural output in the mid-1970s. External factors also played a major role in slowing down the economic activity in the first half of the 1970s. The five-fold rise in oil prices, coupled with an almost 60 percent devaluation of the currency in May 1972, accelerated inflation in the country. During this time, political polarization, disputes among large land-owners and related crime, insurgency in Baluchistan, and then the imposition of third martial law in 1977 were significant indicators of deteriorating law-and-order situation in Pakistan. Further, up to 1979 underground resistance movement prevailed at a high level. All these factors obviously caused a major set back to the economy.

The combined effects of both the domestic and external factors were far reaching. The growth rates of agriculture and manufacturing sharply decelerated to 2.4 percent and 5.5 percent respectively during the 1970s. As evident from Table 1, real GDP grew at an average annual rate of 4.8 percent during the decade of the 1970s. In 1977 the government of Bhutto was overthrown by a military coup under General Mohammed Zia Al-Huq, and Bhutto was convicted of conspiracy in a political murder and hanged.

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This slow-down in economic activity during the 1970s, particularly in the agriculture and manufacturing sectors, would have severely worsened the unemployment situation, if it were not for the Middle-East economic boom. The emergence of that boom stimulated considerable emigration of labor and that changed the picture dramatically in the late 1970s and early 1980s. During the period of 1975-82 the emigration was approaching 2 million workers. In other words, roughly 25 percent of the incremental labor force moved out of the country during the period 1975-82 (Kemal 1987).

Despite the slowing down of the economy the unemployment problem remained manageable during the 1970s, the open unemployment rate hovered around 2.5 percent.

(c) 1980 To 1986

The performance of Pakistan's economy during the 1980s was generally impressive and broad-based even in the face of a number of adverse internal factors. The real GDP grew at an average annual rate of 6.4 percent, manufacturing and agriculture grew at the average annual rates of 8.2 percent and 5.4 percent, respectively. As a result of this impressive performance of the economy, a large part of the addition to the labor force was absorbed. These positive developments were offset by a larger than expected growth rate of population (3.1 percent against the relevant Five-Year Plan's projection of 2.9 percent). The average unemployment rate during the decade of 1980s was about 3.5 percent.

This period was characterized by a decrease in registered crime in all major categories. An obvious factor contributing to this was the fear of arbitrary punishments under the prevailing martial law in the country, thereby forcing various political or criminal propensities to go underground. Despite the termination of Western economic and military aid, there was relative stability in the wake of the 1985 party-less elections.

(d) 1986-89 Years

The Soviet invasion of Afghanistan in late 1979 took a heavy toll on Pakistan's economy. Due to influx of Afghan refugees, especially during the mid-1980s, introduction of drug culture and illicit sophisticated arms, foreign-sponsored terrorism, sectarian strife, flow of black money, and the resultant pervasive environment of political uncertainty, violence and organized crime took the entire country in its

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grip. In the provinces of Punjab and the North West Frontier Province (NWFP), a number of bomb blasts resulting in the deaths of important political personalities and mysterious murders perpetrated by the so-called "Hathora Group" ("Hammer Group") caused an acute sense of insecurity in these regions. In the Sindh province, robber barons, anxious to profit from the political turmoil, created further havoc by their demands, among others, for autonomy. In Karachi, the largest city of Pakistan, ethnic fighting went on throughout 1987, with 243 people being killed according to official figures. By 1988, this violence had expanded almost exponentially; during the month of May, in several outlying parts of Karachi, people riding in cars and on motor bikes were shooting randomly at rickshaw drivers and on folks standing outside movie-houses where Pashto-language movies were being shown (Duncan 1989). As reaction to such developments, further upheaval in the northern areas of the country claimed many lives. As a consequence, the negative impact on the economy was quite evident. The growth rate of the manufacturing sector declined to less than 4 percent in 1988-89, compared to nearly 8 percent in 1985-86. Further, growth rate of the GDP declined from 6.3 percent in 1985-86 to 5.81 percent in 1986-87 and 4.81 percent in 1988-89. The growth rate of the manufacturing sectors fell down to 3.96 percent per annum in 1988-89 from that of 7.55 percent in 1985-86.

The economic slowdown of the late 1980s was accompanied by considerable increase in lawlessness in the country. Some of the main features of deteriorated law-and-order situation during this period may be noted: sectarian and ethnic violence, bomb blasts and domestic terrorism in 1987, availability of sophisticated weapons due to the influx of Afghan refugees, emergence of the drug culture, prominence of black money/crime and Mafia-like robber barons engaged in heroin traffic, increase in fraudulent financial transactions (the later referring often to fictitious loans taken by the influential politicians from nationalized banks and then having the loans written off; during the period 1985-93, there were 261 such loans, each over Rs. 1 million, for a total of over Rs. 1.62 billion).

(e) The 1990s

The period from 1988-89 to 1993-94 witnessed a further slow down in economic activity. The real GDP grew by an average rate of 4.8 percent per annum while agriculture registered an average growth rate of 3.6 percent per annum – these rates considerably slower than

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during some previous periods. A significant slow down was experienced in the manufacturing sector which registered an average annual growth rate of 5.8 percent, compared with 8.2 percent registered during the 1980s. Apart from adverse weather conditions, plus other factors, the precarious law-and-order situation in Sindh in particular and elsewhere in general, along with considerable political uncertainty, contributed to the lackluster performance of the economy during these years.

The slowdown in economic activity during the last six years has worsened the country's employment situation. Prior to 1990-91, about 1.0 million work force used to remain unemployed but in recent years this number has crossed 2 million mark. As shown in Table 1, over 2 million workers, or about 6% percent of the labor force, were unemployed in 1993-94. The early 1990s may be characterized as follows in terms of the law-and-order situation in Pakistan: virtual breakdown of law enforcement with resultant mass insecurity in the general population, rising violent crime again person and property in each of the four provinces, Qabza group (a gang engaged in illegal possession of land for illegitimate purposes) activities sponsored by rival politically influential individuals, gun-running, drug-related crimes, terrorism and subversion, and rising incidence of kidnapping for ransom. Such deterioration peaked during 1994-95, giving rise to almost a state of anarchy and breakdown of law and order; this was the period when in Karachi alone there were at least 1300 murders. There were armed clashes and insurgency in Malakand and in the Khyber Agency regions (NWFP) by the TNSM group (Tehrik-e-Nifaz-e-Shariat-e-Muhammadi, a group keen to impose the Sharia' laws), and widespread incidences of kidnappings, hold-ups and dacoities in each of the provinces. A deadly gang of drug-barons, smugglers and self-proclaimed "mullahs" emerged, each anxious to establish its own turf. Any longer, public confidence in the rule law appears to have vanished.

III. Conclusion

In the foregoing pages we have presented some preliminary evidence that points to a direct causal link between the law-and-order situation in Pakistan and the nation's economic performance during the period 1960 to 1995. During 1960s overall consolidation, political stability and downward drift in crime were accompanied by a growth rate of 6.8 percent in gross domestic product, 10% in manufacturing activities, and over 5 percent in agricultural output. Also during these

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years both the inflation and unemployment rates were relatively low. The deteriorated law-and-order situation and worsened political climate in the 1970s were associated with a decline in the growth rate of gross domestic product (4.8 percent), manufacturing activities (5.5 percent) and agriculture output (2.4 percent). At the same time, the rate of inflation jumped to 12.3 percent and unemployment rate went up to 2.4 percent. Relative stability of the political and crime situations (induced substantially by the imposition of martial law in 1977) during the period from 1980-81 to 1985-86 also brought about an improvement in the overall performance of the economy: gross domestic product increased by 6.4 percent, manufacturing by 6.4 percent, and agricultural output by 5.4 percent. Similarly, the rate of inflation went down to 7.3 percent, although the unemployment rate increased to 3.5 percent due to accelerated population growth and the return of Pakistani migrants from the Middle-East.

Sectarian violence and other incidents of deteriorated law-and-order situation during the years 1986-89 resulted in a decline in the key economic performance indicators: gross domestic product growth rate, 4.8 percent; manufacturing, 4.0 percent; growth rate of agricultural output increased, however, to 6.8 percent, substantially due to improved weather conditions. Inflation and unemployment rates stayed about the same as during the previous recent years. During 1989-90 to 1993-94 the complexity of crime problems was accompanied by a mixed picture of overall economic performance: the gross domestic product grew at about the same rate as during recent years (4.8 percent), manufacturing activities expanded somewhat faster (5.8 percent) and agricultural activities experienced a decline in growth (3.6 percent). On the other hand, the inflation rate accelerated to over 10 percent and unemployment rate increased to over 5 percent, declining growth rates of GDP (4.8%), manufacturing (5.8%) and agriculture (3.6%). The year 1994-95 was again affected by a state of anarchy and breakdown of law and order, accompanied by relatively weak performance of the economic indicators – in particular a substantial increase in inflation rate. For the period as a whole (1960-1995), the summary data in Table 2 reveal that lawlessness and political instability were associated, on the average, with a 2 percentage point decline in the gross domestic product, about 4 percentage point decline in manufacturing and about 3 percentage point decline in agricultural output. The rate of inflation seems to have worsened by about 6 percentage points due to deteriorated law-and-order situation and

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unemployment rate, on the average, worsened by about 1-2 percentage points.

Clearly, domestic tranquility and protection of person and property against violence, as well as internal political stability and security of borders against external threats are the sort of factors that Adam Smith and others have identified as essential conditions for promoting economic growth of nation. Such conditions have been conspicuous in Pakistan by their relative absence during the period covered in this analysis.

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The Future of the Gulf

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BOOK REVIEW ARTICLE

Genetics and Mankind: From the Past into the Future

Pamela Brown
Johannesburg, South Africa

The author reviews a challenging publication which investigates the history of attitudes toward genetics, current prejudices and future trends in bioethics, and the ethics of human reproductive practices in light of ongoing discoveries relating to behavioral genetics and research into the human genome.

Key Words: Human evolution, behavioral genetics, race, eugenics, environmental and genetic conservation, altruism, intelligence, human genome project

Heredity and Humanity: Race, Eugenics and Modern Science
Roger Pearson
Scott-Townsend Publishers, Washington D.C. 1998

As the author observes, the general reading public seem to be largely unaware of the significant role played by the concepts of race and heredity in the history of European and Western thought. As early as the Neolithic revolution (3000-9000 years ago), cultivators had learned how to improve upon various species of wild grasses as well as animals. In Europe, breeding was widely recognized as of equal importance to men as to plants and animals until the Twentieth Century, when politicized academic and media influences reversed this and other age-old patterns of thought.

The Importance of Heredity in the History of Western Civilization

This book therefore begins with evidence of the role heredity historically played in Western civilization. Indeed, in most early societies that achieved an advanced culture, the community was seen by its members as an intergenerational affair, with family and ancestors playing an important role in the ideology of the society. The term "race" or its equivalent was commonly equated with the idea of a lineage, a group of people descended from a common ancestor or common ancestors. Life did not begin or end with the individual. Thus, for example, it was the sense of common descent from the same ancestral

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forebears, of belonging to a specific community of families, that held the free men and women of the Greek city-state together.

Biological reality was reflected in religious concepts; reproduction in ancient Europe was considered a religious duty; the individual was seen as the product of the forces of biological causality, a living link in the chain that was the lineage; just as the lineage comprised a vital component of the nation-state; and the nation-state was a distinctly biological unit, with its own distinctive pool of qualities.

References are drawn from Homer's *Odyssey* and the *Iliad*, as well as from Aristotle in the age of Classical Athens, from *The Achaean Kings* (L.R. Palmer, 1995); and from *The Hellenic Ideal* (Werner Jaeger, 1945).

Because of their respect for breeding, the Greeks, the Romans, the Celts and the Germans all honored their women as the progenitors of the race. The desirability of breeding from proven stock became a cultural requirement, and usually only children born of legitimate wives (that is, of quality ancestry) could inherit the social status of the father. In ancient Athens and other Greek city states, the eupatrids "persons of good ancestry") were men descended from no less than nine generations of untainted noble stock on both sides of the family tree.

Plato's interest in eugenics is well known, and he praised the Spartans for their eugenic breeding policies (*Laws*, 630). Aristotle was equally impressed by the need to breed good stock. Theognis of Megara constantly praised the importance of heredity (Theognis, V 183). Racial purity was linked to physical appearance, with Spartan women being renowned for their beauty; and character was seen as inherited along with personal features (*Stobaeus*, lxxxviii, 71). Other authorities quoted are Alcmeaon, Heractus, and Meleager.

The early Romans also held lineage in great respect and enforced a system of *connubium*, whereby freeborn Romans might only marry into certain approved stocks. However, the Romans were relatively few in number and when their military and administrative talents expanded the Roman Empire until it became a wide multi-ethnic community, egalitarian ideologies eventually subverted the biological consciousness of the Roman world, as the ancient Roman stock became depleted and reduced to demographic insignificance. In the end the Roman Empire, a weak "multi-cultural giant", was submerged before the onslaught of the more homogeneous Germanic nations.

The Germanic peoples (the Germans, Dutch, Flemings, Anglo-Saxons, Franks, Lombards, Scandinavians, Goths, Burgundians

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and Vandals) – who founded so many of the modern states of Europe after the demise of the Roman Empire – carried the concept of heredity to its logical conclusion in their virtually unique system of kinship.

Unlike their racial kinsmen – the Greeks, Italics, Celts, Slavs and East Balts – they did not organize themselves in patrilineal clans and phratries, but held even more direct, biological, view of kinship. The Germanic "kindred" comprised all the individual's relatives on both the paternal and maternal sides, assessing the degree of closeness according to their actual genetic relationship. The Germanic kindred was the subject of the exhaustive study *Kindred and Clan in the Middle Ages and After* (M. Phillpotts, 1917). To this day, wherever Germanic traditions survive, the Germanic concept of kindred, recognizing biological closeness as the true basis of kinship, still survives.

In ancient Scandinavia the belief in inherited talents was reflected in the concept of hamingja, an inherited "luck" force. Kings who were "unlucky" and under whose leadership things went badly, were replaced by more competent individuals from the same royal lineage that had produced generations of successful leaders. The belief in breeding and the inter-generational transmission of qualities was overriding.

Most Indo-European peoples, including those who lived outside the geographical borders of Europe, trusted in the powers of heredity. In *The Religion of India* (1958), Max Weber described the semi-magical power known as *xvarenah*, attributed to successful Indo-Iranian kings as a belief in inherited ability, calling it "familial charisma". The millennia-long Indian caste system was sustained by a similar belief in the genetic inheritance of human qualities. The charisma of a caste and of a family, was genetically transmitted; its roots were to be found in the concept of inherited ability.

The Coming of Christianity

The coming of Christianity clashed with the established and ancient European belief in the *inequality* of men. Spreading first among the slaves and lowest classes of the *Roman Empire, Christianity came to teach that all men were equal in the eyes of a universal Creator God, an idea that was totally alien to older European thought, which had recognized a hierarchy of competence among men – even among the gods. As Max Weber expressed it, Christianity carried the anti-intellectualism of the Middle Eastern prophets to its extreme.

However, although Christian intolerance under Constantine closed

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Plato's academy some 900 years after its establishment on the grounds that free thought challenged revealed dogma, traditional European appreciation of the significance of heredity never completely died. Prior to Christianity, heroes and other national leaders had been regarded as superior because of the characters they acquired by descent from famed ancestors or even from the gods. Most Germanic royal lineages, for example, were believed to be descended from Woden. In free, unconquered clans, tribes and nations, kings were symbolic figures, respected rather like elder brothers (The English word "king" derives from Anglo-Saxon *cyning*, meaning "the essence of the kin"). In ancient myth, heroes might even challenge the gods.

The Christian church, jealous of the "divinity" awarded to kings and nobles by virtue of their descent, but finding it convenient to win their goodwill, avoided challenging their "divine right', but converted this into the right to rule as earthly representatives of the Christian God – as long as they obeyed the wishes of the Church leaders as the earthly mouthpieces of that God. However, the "divine right' to rule with the church's approval was a very different concept from the "divine" powers that were associated with descent from a long line of proven achievers. As a result, the idea of genetic differences came to be subtly discouraged by the church. Stripped of the notion of the state as a kinship unit, and preaching the essential equality of all men and women as the "children of God", dissident sects promoting radical, egalitarian ideals arose over the course of time to protest social and economic inequality.

Secular political movements also began to assert the idea of biological equality, a theme which tended to be favorably received whenever malcontents in a divided society provoked revolt. Such was the case of the Levellers who fought alongside the Parliamentarians in 17th Century Britain; of the Jacobins who decimated the aristocracy of 18th Century France; and the Bolsheviks who wrought genocidal slaughter among the more successful members of Russian society, nobles and peasants alike, following the Bolshevik revolution in the early 20th Century.

In recent times, revolutionary forces have often attacked what they call "genetic determinism" in favor of the alternate, unrealistic, philosophy of "biological egalitarianism". Under Stalin, who sought to spread revolution among the Third World masses, Marxist theoreticians rejected any suggestion that economic inequality could in any way be explained by biological inequality, or that one individual or nation

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might be inherently more creative or productive than another.

The Discovery of Evolution

Pearson then turns his attention to those gifted scientists who made a quantum leap in human self-perception – by recognizing that mankind is a part of the animal world, and is governed by the same biological principles. He prefaces this section by saying: "Yet even while the myth of biological egalitarianism was gaining ground in the Western world, the momentum of scientific enquiry freed by the Renaissance from the shackles of medieval religious dictates - was deepening Man's knowledge about himself and the world around him. Furthermore, renewed interest in selective breeding for plants and animals in the 18th Century agricultural revolution focused attention once again on the significance of heredity."

In 1859, Charles Darwin restored the concept of heredity to its rightful place with his epic work, *The Origin of the Species by Means of Natural Selection or the Preservation of Favored Races in the Struggle for Life*. In this he described the process by which living populations of both plants and animals evolved into different races or stocks in competition with rival populations, to produce the enormous variety of living species that populate the global biosphere today. Himself inheriting the qualities of a highly talented stock, it was Darwin's cousin, Francis Galton, who pioneered the science of statistics as he sought to understand the process of inheritance. Together with Karl Pearson, Galton founded the science of eugenics [Gr. *eugenes* = "well-born"]. In Galton's own words, the purpose of genetic science was

> to give the more suitable races or strains of blood a better chance [to reproduce]. . . " He describes eugenics as "that science which deals with all influences that improve the inborn qualities of a race; also with those that develop them to the utmost advantage" (1909): "Man is gifted with pity and other kindly feelings; he has also the power of preventing many kinds of suffering. I conceive it to fall well within his province to replace Natural Selection by other processes that are more merciful but not less selective.

Galton argued that it was scientifically possible to increase the frequency of desirable qualities among human beings, and to prevent the spread of deleterious qualities, by eugenic measures. He realized, too, that nature and nurture work in tandem and should not be seen as

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mutually exclusive opponents. Heredity was important, but so was a healthy and favorable environment.

Darwin was impressed by his cousin's ideas. Two years later in *The Descent of Man* he noted:

> ... [The various races, when carefully compared and measured, differ much from each other – as in the texture of their hair, the relative proportions of all parts of the body, the capacity of the lungs, the form and capacity of the skull and even the convolutions of the brain. But it would be an endless task to specify the numerous points of difference. The races differ also in constitution, in acclimatization and in liability to certain diseases. Their mental characteristics are likewise very distinct; chiefly as it would appear in the emotion, but partly in their intellectual faculties.

Thus both members of this gifted family, Darwin and Galton, came to the same conclusion, expressed by Galton in *Hereditary Genius* (1869) as follows:

> It is in the most unqualified manner that I object to pretensions of natural equality. The experiences of the nursery, the school, the university, and of professional careers, are a chain of proofs to the contrary ... In whatever way we may test ability, we arrive at equally enormous intellectual differences.

Galton's younger colleague, Karl Pearson, laid the foundations of modern scientific method in his *The Grammar of Science* (1892). He, too, realized that the genetic legacy each generation leaves to its successors is of prime importance for the future of mankind. Every generation in fact sifts and determines which genes are to survive. In his Huxley Memorial Lecture of 1903, he warned that:

> ...the mentally better stock in the [British] nation is not reproducing itself at the same rate as of old – the less able and the less energetic are the more fertile. The psychical characters which are the backbone of a State in the modern struggle of nations are not so much manufactured by home and school and college; they are bred in the bone...

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Support for the Eugenic Ideal

Readers in the 21st century are likely to be astonished at the openness and enthusiasm of those prominent people and leaders who supported the eugenic ideal. Support came from a wide range of varied intellectuals, not only traditionalists, but also progressive thinkers like George Bernard Shaw, H.G. Wells, J. Maynard Keynes, Julian Huxley, J.B.S. Haldane, the Webbs, and Havelock Ellis. Scholars and politicians alike applauded the new sense of responsibility in procreation, such as the Cambridge biologist Francis Maitland Balfour; founder of the British school of evolutionary biologists British Prime Minister Arthur James Balfour; and the young politician Winston Churchill. Prime Minister Arthur Balfour delivered the inaugural address at the first International Eugenics Congress held in England in 1912. Co-sponsors of that Congress included Winston Churchill, Alexander Graham Bell, Charles William Eliot (former president of Harvard University), and the Bishop of Ripon (England).

Galton and Karl Pearson established and ran a "biometrics laboratory" at the University of London for the primary purpose of studying heredity in man. The Eugenics Society was also founded, aided by financial from Galton. Patriotic Englishmen who feared a dysgenic trend in national ability eagerly supported the eugenic doctrine that the fittest, most intelligent and creative parents should be encouraged to have larger families (positive eugenics). The Fabian Socialists sought to decrease what was seen to be an excessive rate of reproduction among the genetically unfortunate (negative eugenics). Julian Huxley wrote:

> ...[Eugenics] is not merely a sane outlet for human altruism, but is of all outlets for altruism that which is most comprehensive and of longest range." ("Eugenics and Society" in *Man in the Modern World*, 1941)

European and American scholars soon responded to the eugenics ideal. President Theodore Roosevelt wanted only quality immigrants from ethnic stocks which would readily assimilate into the "Old American" population. Americans even then were debating the question of immigration, since they instinctively knew that immigrants affect what we would today call the national gene pool. The eugenic ideal matched perfectly the forward-looking spirit of the people of the United States as they entered the 20th Century. The hopes of the eugenicists were raised in 1910 by the establishment of the Cold Spring

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Harbor Eugenics Record Office by the Carnegie Institute of Washington. Leading society and scientific personalities directed and supported this society. Alexander Graham Bell supported eugenics conventions, and authored several papers on the subject.

The Galton Society, formed in New York in 1918, became actively involved in endeavors to shape U.S. policy relating to population quality. Eugenics societies sprang up in many American cities. In 1923 the American Eugenics Society was established with branches in numerous American cities. Other eugenics organizations proliferated at that time, and the Eugenical News was published.

Ales Hrdlica, the famed anthropologist of Bohemian origin, was a recent immigrant to the USA. A doctor of medicine, his main interest was the problem of human quality and the significance of racial differences, which he saw in an evolutionary context. He emerged as America's leading physical anthropologist, serving as editor of *The American Journal of Physical Anthropology*, and as first president of the American Association of Physical Anthropologists. Hrdlicka warned against "race deterioration, a decline in the genetic qualities of a population, and also of "race destruction," the loss of distinctive genetic qualities "through complete submergence into another race "or simply by failure to reproduce itself, observing:

> There are still some benevolent minds who would like to see all men, white and black, potentially equal. Yet they will hold that there are differences between one family and another family, and even between the children of the same family, in the same racial group ... As a matter of fact, there are similarities, but no absolute equality anywhere in living nature, either in races, or families or even individuals. The problem is merely how great in a given case is the dissimilarity. Races, especially the further distant ones ... are not equipotential ..." (Race Destruction and Deterioration" *in The Proceedings of the Third Race Betterment Conference*, Battle Creek, Michigan, 1928)

The Race Betterment Foundation, which sponsored the conference at which Hrdlicka presented these views, was founded by industrialist and surgeon John Harvey Kellogg (of Kellogs Cornflakes fame). The eugenics movement was enthusiastically supported by renowned American scientists, educators, museum directors, biologists, university presidents and astronomers.

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Psychologists who were interested in intelligence also tended to involve themselves with the new ideal of population improvement. The prominent psychologist R.M. Yerkes is particularly remembered for his mammoth WWI study of the IQ ratings of 1.75 million U.S. military recruits, compiled while he was head of the psychology division of the office of the U.S. Surgeon General. He and other prominent psychologists became involved in immigration control. Charles Conant Josey stressed the significance of heredity and also of nations as cohesive micro-races in determining the trend of history, and became a bitter opponent of internationalism and the trend toward lowering national barriers to permit mass movements of surplus population around the world, destroying the biological achievements of separate evolution resulting from genetic segregation over thousands of generations of disparate selection.

Sociologists of the period similarly noted the significance of race and heredity, including Edward Allsworth Ross who, in his book *Standing Room Only!* (1924), accurately forecast the population explosion which today threatens to endanger the ecological basis on which so many of the higher life forms on this planet depend. Another sociologist, Robert MacIver, wrote that although material products were readily diffused from one people to another, cultures tended to be specific to particular populations in that they were linked to temperament and personality.

Conservation of Environment as well as Genes

In a separate chapter, Pearson points out that it was mainly those who were anxious to conserve the genetic heritage of mankind who pioneered the conservationist movement, most notably Gifford Pinchot. The list is a long one and includes Madison Grant, and the founders of the New York Zoological Society in 1893. As Pearson observes:

> It is only logical that eugenicists should be ardent conservationists: the humanitarian idealism of the first decades of the 20th Century was the natural outcome of discerning and cultured men and women. These were people who deemed it their duty to leave the world a better place than they had found it ... Many eugenicists were conservationists first and last ... Much of what has survived to the present day is a result of their efforts [such as Yellowstone Park, and Glacier National Park]. The success of the conservationist movement was facilitated by the sympathy of

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> President Theodore Roosevelt who was deeply concerned about the threat to the quality of both the natural and human stock of America. Henry Ford was another creative American who was concerned about preserving both the quality of the population and the quality of the environment.

"These men and women," continues Pearson, "were inspired by a noble sense of public duty and although subsequent generations have not preserved the high level of genetic and environmental conservation to which they aspired, something at least of their spirit still exists, and the overall logic behind their views has since been demonstrated to have been totally sound."

Race as a Nation-building Ideal

Many early socialists, such as William Morris in England, envisaged nations as they had originally been – as kinship units whose members ought properly to care for each other and for the children who represented the nation's future.

British paleontologist Sir Arthur Keith saw nations as separate breeding populations, each potentially emerging as mini-subspecies, and warned against any dysgenic decline in intelligence. Indeed, he suggested that dysgenic trends may have been responsible for the collapse of the earlier urban civilizations of antiquity:

> Babylon, Egypt, Greece and Rome did not fail for lack of children, but for a dearth of children of the right kind. There is no doubt that civilization exposes the ablest of her votaries to an extreme temptation – the temptation of luxury. The basal and essential condition for racial progress is a healthy birth rate – in every grade of every community. As we raise our standard of living, the more expensive becomes the maintenance and education of our children; we become more and more tempted to spend on ourselves what should be sacrificed in raising another generation. (*Concerning Man's Origins*, 1928)

In America the Nobel Prize-winning geneticist Hermann Muller put it this way:

> Civilization affords an excellent chance to breed for many sorts of the weak, the stupid, and the vicious characters which are

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> continually arising. Actually, there are indications that under civilization many traits that are detrimental to the species as a whole are propagated at a faster rate than the normal, so that the otherwise exceedingly slow biological degeneration is thereby hastened. (*Out of the Night*, 1935)

William McDougall, the noted psychologist, also expressed concern about the fact that in complex societies the more intelligent generally failed to reproduce at even replacement level.

Today, the low birth rate among the Western and more advanced nations of the world, and the massive ongoing population explosion in the Third World, have rendered the views of these early eugenicists prophetic. Even the Chinese of Singapore, who have attained a high level of civilization and economic success, have noted and expressed concern over the low birth rate among the more intelligent and educated of their womenfolk. Both Charles Darwin's son, Leonard Darwin, and his grandson, Charles Galton Darwin, have stressed the threat to civilization of the vast increase in population in the more backward parts of the World as a result of modern medical advances.

Thus, just when it seemed that the nations of the Western world were arriving at a new level of social and moral responsibility, albeit without the more advanced scientific understanding of genetic science which we have since acquired, World War I brought political and genetic havoc upon the Western world. Europe was the most severely affected – with Britain and France suffering genetic losses from which they never recovered – but it also led to changes in America. The public's confidence in the future was shattered by the Great Depression, and "the forces of revolutionary socialism," writes Pearson, "seducing significant segments of the public by painting a fanciful image of a distant egalitarian paradise, were the only beneficiaries of the disastrous maelstrom of destruction wrought by the war ... [in these circumstances] the Revolutionary socialist creed of egalitarianism steadily won control of the high ground".

In Russia, the massive losses of WWI led to violent revolutionary victory for those who preached anti-hereditarian views. Even in Western Europe and North America, where there was no violent Marxist seizure of power, the forces of social revolution made egalitarianism their slogan. This changeover from idealism and concern for the future to crude appeals to the material interests of the present, weakened the bonds of national kinship and loyalty by promoting class

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warfare, and by dividing men against women and the young against the old.

British philosopher Bertrand Russell, repected liberal philosopher and known for his concern for the well-being of all peoples of whatever rank, saw the threat of dysgenic reproduction to modern society, and lamented:

> More serious is the effect of a scientific civilization upon population – not upon quantity, which is unimportant, but upon quality. The most intelligent individuals, on the averagc, breed least, and do not breed enough to keep their numbers constant, Unless new incentives are discovered to induce them to breed, they will soon not be sufficiently numerous to supply the intelligence needed for maintaining a highly technical and elaborate system. And new incentives will have to be far more powerful than any that seem politically feasible in any measurable future. In America and Great Britain, the fetish of democracy stands in the way; in Russia, the Marxian disbelief in biology. Wherever the Catholic Church is strong mere quantity tends to be thought alone important. In France, the economic system that has grown up around the Code Napoleon makes any eugenic reform impossible ("Science" in *Whither Mankind*, Ed. Charles A. Beard, 1928).

Boasian Distortion

But it was Boasian anthropology that eventually became the intellectual spearhead of biological egalitarianism. Pearson goes into some detail about the socialist egalitarian political convictions of Boas and other anti-hereditarian activists.

Born in Germany in 1858, Franz Boas' family was intimately interconnected with the European revolutionary socialist movement. His mother was a life-long radical activist, and an uncle, Abraham Jacobi, had actually been imprisoned for armed violence. Boas started life as a journalist for a Left-leaning publication, but emigrating to the USA, where he already had activist relatives, it was suggested that he should make a study of the Eskimos or Inuit. Thanks to a competent ethnological survey of these people, sympathizers were able to support his entry into the academic world and his eventual rise to become head of a newly created department of anthropology at Columbia University. Here he sought and obtained authority to grant doctorates in anthropology, the first such degrees to be granted at any American

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university. As a result, the students he trained tended to receive priority as new positions opened up in anthropology in universities around the United States.

All his academic life, Boas waged a cleverly disguised campaign to weaken national and ethnic consciousness and to 'combat racism'. His writings such as *Anthropology & Modern Life* (1928) and *Race, Language & Culture* (1940) downplayed the importance of heredity amongst humans, as though humanity was exempt from the laws of biology that governed all other forms of life, and by doing so undermined the eugenic ideal. Many academics abandoned the Darwinian struggle, and started to think of the diverse races of humankind as being members of a single, worldwide, gene pool. This was a reversal of the evolutionary process which was rooted in diversification.

In the West a false altruism took hold promoting genetic homogenization. Much of the egalitarian bias in anthropology, writes Pearson, can be traced to the influence of this one individual, who though highly competent was committed from his childhood to strong egalitarian-revolutionary credentials and contacts. It is a fact that the U.S. House of Representatives attributed Boas with no less then forty-six communist-front connections. Many of his more favored students also formed links with communist-front organizations.

The apple doesn't fall far from the tree, and his students sought to revolutionize Western thinking, by social programs and by minimizing the role of heredity in the shaping of human abilities. Writers, lecturers, museum curators, they included Margaret Mead (praised by fellow-travellers as the "mother of American anthropology," but since academically discredited), whose propaganda pamphlet, *The Races of Mankind* (1948), co-authored with Gene Weltfish, reflected core of Marxist-Leninist doctrine and portrayed race as a cultural invention designed to keep the colored races in submission. Melville Herskovits, Ashley Montagu (born Israel Ehrenburg), Ruth Benedict, Isador Chein, Kenneth B. Clark, Otto Klineberg, Leslie Spier and Gene Weltfish, also formed part of the formidable list of the Boas school's politicized scholars. The Boasians came to dominate the academic scene as appointed faculty members, working sympathetically to advance those of their students who had accepted their views.

Egalitarianism Triumphant

As if the disputes between factions inside the eugenics movement, WWI, the Depression, and the rise of the Boasian school of anthropology were not enough to crush those who still recognized the

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importance of genetics, a new ideology – neo-Marxist, Stalinist Lysenkoism – made its appearance. Writes Pearson:

> In Russia, a quack geneticist named Trofim Lysenko rejected Mendelian genetics, and claimed that the environment could directly modify the genome. This fallacy, linked to the equally erroneous Lamarckian doctrine that adaptations acquired during the lifetime of individual organisms could be inherited by that organism's offspring, reduced breeding to philosophical irrelevance, thereby promoting the cause of egalitarians and those who believed they could re-shape mankind at will by means of environmental manipulation without the need to resort to any form of genetic selection. The Lysenkovian theory was adopted by Stalin, who declared Mendelian genetics to be a capitalist conspiracy, and acceptance of the Lysenko fallacy became mandatory throughout the Soviet Union. Lysenkoism justified the doctrine of revolution by consigning Mendelian genetics to oblivion: if all races and individuals were potentially equal, given the appropriate manipulation of their environment, the argument that all economic inequality was the product of class exploitation would be logically justifiable....
>
> Scientifically, the spread of egalitarian theory was [further] encouraged by the behaviorist doctrine of J. B. Watson (1878-1958) ... which saw human beings as plastic entities capable of being molded entirely by their environment and training. An extreme environmentalism was developed and extended by John Dewey (1859-1952), who believed that environmental manipulation could totally reshape human behavior, and whose influence on American education persists to this day.

Traditional European educational philosophy, which had placed great importance on a strict regime of education and moral training for the young, differed from the "new behaviorism" in that it had fully recognized the limits on potential imposed by heredity, whereas the new egalitarian creed sought to exclude biological factors, arguing for the uniformity and "plasticity" of the human mind. Lysenkoism remained for many years the only legally permitted form of genetics in the USSR, and in the West, the victory over race-oriented Germany in the Second World War channeled funding and political support toward research favoring egalitarian theories, so that even government policies

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became subservient to the new egalitarian orthodoxy.

In Western academic circles, the idea of any biological inequality in the distribution of abilities was now portrayed as nothing more than an artificial justification for what Marxists called "class exploitation". To even point out that some populations were biologically superior in particular competitive sports could invite the speaker to be denounced as "racist". Boasians were joined by other blatantly radical academics, and a sort of guerilla warfare was conducted against a number of academics who insisted on publicly acknowledging the role of heredity in human behavior.

Media Bias and Academic Persecution

The political left came to realize that biological inequality and the "survival of the fittest" were incompatible with the notion of equality, and so from the 1930s onward scarcely anyone outside of Germany and its Axis allies dared to suggest that people might be genetically different from each other, lest it should imply support for National Socialism. Meanwhile, writes Pearson, "those who propounded the myth of biological egalitarianism were free to write what they liked, without fear of contradiction."

Even prior to post-World War II decolonization, the onslaught against apartheid in South Africa, and the U.S. civil rights movement, gave further impetus to the attack on genetic differences. Thus, by 1941 Albert Hooton felt obliged to complain that:

> In the USA, which is a welter of races and transplanted nationalities, one can assert without much fear of contradiction and with every expectation of applause that all races are equal in ability and in cultural achievement and that there is no relation between race and culture. No one's ox is gored thereby and nobody bellows. But if you suggest to the contrary, every ethnic strain with an inferiority complex becomes vociferous in protest. (*Why Men Behave Like Apes and Vice Versa*, 1941)

In the academic world racial differences were minimized, even between such diverse peoples as those of Japan as contrasted with those of the Congo, and such behavioral differences as were admitted were attributed solely to differing economic or social arrangements. Furthermore, in the 1960s and 1970s, openly violent intimidation was perpetrated by Marxists and other leftist activists against scholars who

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refused to ignore the genetic component behind human behavior. Marxist campus riots aimed at "racist" professors were frequent, such as those against the Nobel Prize-winning William Shockley, and the distinguished Berkeley psychologist Arthur Jensen, as were disruption of lectures, threats against faculty members.

By the 1980s, violent revolutionary activities gave way to infiltration as the favored activist tactic. As activist students graduated and won appointments as faculty members, administrators and government employees, many universities began to impose discriminatory guidelines as to "racially sensitive" and "politically correct" terminology.

Activist egalitarians – fearful that hereditarian research might undermine the ideology upon which their "scientific" beliefs were based – resorted to character assassination, personal attacks and moral innuendoes against those who continued to research genetic differences in behavior. They found ready allies in the media. Politicized distortion of scientific findings was not limited to the popular media, but also some of the scientific journals such as the Scientific American, which attacked the Minnesota Twin Study, *The Bell Curve* (Herrnstein & Murray, 1994), and even the memory of distinguished British academic Sir Cyril Burt, among others. This bias was been documented by unimpeachable scholars such as Bernard Davis (see his *Storm over Biology: Sentiments and National Policy,* 1986), who showed how irrational public policies were based on the false premise of biological egalitarianism and the idea that contemporary *Homo sapiens* was somehow exempt from the laws of genetics.

But Research Continued

The fate of scientists like Galileo at the hands of the Inquisition had its parallel in modern times. Yet, in spite of the apparent Boasian victory in the post-WWII period, a number of outstanding scientists nevertheless continued to do key research into the role of heredity in shaping human personality and ability.

World-renowned botanist and geneticist, C.D. Darlington, warned that selection changed the character of the world's population in every generation, and that "the nation which takes most serious thought for its own genetic future is, therefore, most likely to have a future." In 1968, Frederick Osborn argued for the need for eugenics to eliminate harmful genes from the human gene pool. Similarly, John R. Baker, emeritus reader in cytology at Oxford, catalogued human subspecies

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and populations around the world and throughout recorded history, linking them to the different levels of civilization attained. The famed Linus Pauling warned about the dysgenic threat facing contemporary humankind:

> ... Defective genes are now not being eliminated from the pool of human germ plasm so rapidly as in the past, because we have made medical progress and have developed feelings of compassion such as to make it possible for us to permit the individuals who carry the bad genes to have more progeny than in the past. Moreover, defective genes arc being manufactured at a greater rate than in the past, because there are new mutagenic agents operating in the world today ("Molecular Disease" *American Journal of Orthopsychiatry*, 1959).

Ernst Mayr, the renowned biologist, similarly stressed in 1963 the link between heritability and intelligence, and the fear that the Western world might not be passing on its best genes (*Animal Species and Evolution*, 1963).

But it was Berkeley psychologist Arthur R. Jensen, who succeeded in bringing the role of heredity to the attention of social scientists with his paper entitled "How Much Can We Boost IQ and Scholastic Achievement?" (*Harvard Educational Review*, 1969), which created shock waves among the ensconced egalitarians. His subsequent books explained the importance of genetics in determining human intelligence in even greater detail. University of London psychologist Hans Eysenck and the renowned psychologist Raymond B. Cattell added to the store of knowledge in *The Fight for our National Intelligence* (1937).

Other significant contributions in the fields of psychology and intelligence have been made by E.O. Wilson, William B. Shockley, James Q. Wilson, Charles Murray, J. Phillipe Rushton, and others. But Pearson warns that intelligence is not the only genetically based quality essential for human cultural achievement. Other factors, such as the ability to engage in sustained long-term planning and activities rather than to simply respond to immediate challenges and to seek only instant gratification are also vital to the ability to create and sustain civilization and scientific progress.

Contemporary Investigation of DNA

In spite of the welter of condemnation from egalitarians and the

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mainstream media, significant genetic research continues in the areas of identical twins, blood groups and more especially DNA. As we now know, the ability to analyze and classify human DNA has advanced rapidly in recent years. An individual's DNA is as unique as his fingerprints, but also indicates with which other people he has close genetic kinship or racial links.

Structural alterations in the DNA are termed mutations. Genetic research is aimed at the eugenic goal of being able to replace or correct deleterious mutations that handicap living organisms.

Unscientific suggestions that there is very little difference in the DNA of living human populations are simply a red herring. In fact, the vast majority of human nucleotide bases, out of an estimated total of some three billion per person, are shared with other non-human life forms. For example, it has been estimated that of these three billion, only two to ten million differ amongst living humans. According to one estimation of genetic relationship, human DNA differs from chimpanzee DNA by no more than 1.6% overall! Yet this difference is of enormous importance. Thus although egalitarians have made a lot of noise about the small percentage of human genes that distinguish human races or populations, when one realizes how small, also, are the number of genes that separate men from mice, cows or other mammals, the importance of these genetic differences becomes apparent. Political pressures have led to much misrepresentation regarding human genetic differences, and even the researchers are obliged to veil their findings in political acceptable language.

This is notably the case with recent research on DNA and similar genetic profiling, even though has already begun to be used to assist historians in determining the racial history of populations by revealing their genetic components. L.L. Cavalli-Sforza, while seeking to avoid criticism by distancing himself from the concept of race, has extensively researched the genetic history of living human populations and, together with co-authors Menozzi and Piazzi, and in *The History and Geography of Human Genes* (1994) he embarked on an important exploratory odyssey into the historical and genetic relationships that demarcate the living populations of humankind throughout the world. In time, the complex web of historic migration and genetic admixture might well be untangled with considerable precision. Summarizing the worldwide data in a singular 42 x 41 matrix, illustrating genetic distance, Cavalli-Sforza and his co-authors find that the English differ from the Danes, Germans and French by a mere 21-25 points of genetic distance,

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whereas they differ from North American Indians by 947 points, from the African Bantu by 2288, and from Mbuti Pygmies by 2373. Even though they have deliberately ignored racial classifications, the racial patterns that are revealed in their study coincide very closely to the conclusions of traditional anthropologists.

Pearson commends the work achieved by Cavalli-Sforza and his colleagues with the following words:

> The argument about whether or not 'races' exist has become purely a matter of semantics - of what exactly the debaters understand by the term 'race'. Distinct gene pools and breeding populations have existed since soon after sexual reproduction first evolved; otherwise, there could have been no speciation and no evolution. If we accept the term 'race' in its original sense - as referring to a lineage, and by extension to any group of people of essentially common ancestry who share to a recognizable extent a certain distinctive genetic pattern - the term presents no scientific difficulties whatsoever. In short, their findings as to the degree of similarity and difference between surviving populations of *Homo sapiens* are essentially parallel to those of the older-school physical anthropologists represented by Carleton Coon.

Significance of the Human Genome Project

Appreciation for the role of genetic forces in determining human qualities has led in recent years to the establishment of numerous human genome research projects in the U.S., Britain and other countries. In spite of the sway of anti-biological environmentalism still found in the social sciences, the HGP is focusing attention on the reality of human biology. Breakthroughs in molecular biology have made possible the construction of a human genome map, consisting of a schematic representation of each chromosome, showing the bands and approximate location t)f each of thousands of genes. The construction of genetic linkage maps – with special attention to those responsible for human defects – is advancing.

The genome project has two major implications: first, the potential for promoting eugenic remedies for inherited predisposition of diseases; and secondly, the light it can throw on the nature and extent of human racial diversity.

As Marc Lappé (in *Justice & the Human Genome Project*, 1994) has said:

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The products of the genome project may throw into stark relief the paradox of a society based on the premise of equal standing at creation and one that is found to be composed of a genetically heterogeneous group of subpopulations with quantitatively different frequencies of heritable traits. As a society we will have to ask if we can in fact collect information that reveals these individual differences and still continue to treat all individuals the same ... What is clear is that even a partial picture of the genetic landscape that defines the molecular differences among human individuals will reveal more its non-uniformity than its hoped for universality.

Pearson comments:

The human genome project helps to remind us that we are, after all, biological organisms just like other animals, and even plants. It should make us realize that we need to bring ethics into line with biological reality, into line with the reality of,evolution and the universe. It is essential that human culture and human ethics should be in line with the realities of the universe, and those realities include our own human biological nature. It should also serve to remind us that racial or genetic differences are real and important, and that the culture on which we rely for survival itself depends on biology and hence on our genetic heritage ...

Contrary to previous egalitarian supposition and propagandizing, significant genetic differences distinguish historically isolated populations or gene pools. A prime question for the future is the extent to which historically separate populations - some of which have evolved further in certain directions than others - will be able to preserve their distinct genetic characteristics in an increasingly overcrowded and mobile world. Evolution was able to proceed amongst hominids, as amongst other life forms, as a result of genetic isolation, which was initially facilitated by geographic isolation. Only after geographic isolation had created a wide variety of subspecies ... did subspecific or 'race' prejudice – what G.G. Simpson regards as a psychological restraint on cross-breeding – come into being as an evolutionary mechanism serving to preserve subspecific identity amongst increasingly mobile species. The co-habitation of individuals of diverse genetic origin in the same geographical location, and the probably further decline of 4 race prejudice' may reverse the prehistoric evolutionary trend toward subspeciation and initiate a reversal of nature's evolutionary tactics.

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Egalitarians fear that results from the HGP will destroy the credibility of their universalist ideology, and that revelations about the true extent of group differences in genetic potential will explode the anti-evolutionary myth of universal biological uniformity. This was why such strenuous efforts have been made to emasculate the HGP in Europe and to block any eugenic trends that might result from it.

The Impact of Modern Medical Science

There is now light at the end of the tunnel, however. While the Lysenkoist tradition still raises some barriers to research into behavioral genetics, research into the role of heredity in medicine is now accepted, and the evidence is this field is so plain it must eventually spill over into more general fields of human behavior.

It is now more than 60 years since Nobel prize-winner, geneticist Hermann Muller, wrote in *Out of the Night* (1935):

> Civilization affords an excellent chance to breed for many sorts of the weak, the stupid, and the vicious characters which are continually arising ... So long as this condition holds, then a biological disorganization will take place, and will necessarily continue without limit, or until the species disappears ... Under civilization many traits that are detrimental to the species as a whole are propagated at a faster rate than the normal.

Today, medical science, as part of civilization, is a mixed bag, facilitating both eugenic and dysgenic trends.

In the same work, Muller repeatedly warned that:

> In a state of nature, the problem of the accumulation of defective genes was often taken care of by 'natural selection' ... The only adequate alternative to it, however, is some kind of thoroughgoing eugenics ... Failing this, a biological deterioration of the human race seems inevitable, and this might even endanger the dominance of man as a species.

Medical science has a dysgenic impact when it defeats nature's normal tendency to reduce harmful genes being transmitted to future generations. Sir Julian Huxley warned against this in his Introduction to Robert S. Cook's book *Human Fertility* (1951):

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> We can be certain on theoretical grounds that the relaxation of selection brought about through our medical knowledge and social care must be causing a slow degeneration of the stock, through the accumulation of harmful mutations.

Comments Pearson:

> Today the 'genetic load' of harmful genes is widely spread throughout the outbreeding populations of the modern Western world, and many of those who inherit the finest collection of genes must necessarily be cursed by the inclusion of one or more dysfunctional genes ... To preserve posterity from genetic pollution, it is imperative that geneticists should be encouraged, not discouraged, to search for techniques which will make it possible to substitute healthy genes for faulty ones.

He reminds us that when eugenics first became popular, genetic knowledge was too limited to facilitate negative eugenics (the reduction of harmful genes in the gene pool) in any but the most crude manner, and much was done that was tragic and repulsive. But modern technology – genetic engineering – makes it possible to replace deleterious genes with healthy genes. We can now look forward to the days when the breeding of reliably more healthy and competent stock can be promoted by ethically sound medical intervention.

This, however, will not solve the total dysgenic threat. Positive eugenics – encouragement of larger families among healthy and competent individuals – will still remain a pressing necessity because "the failure of any generation to replicate its best biological specimens means that their genes are lost forever."

The Welfare of Those Yet to be Born

One cannot help warming to a man of science - writing at a high intellectual and moral level, and skillfully weaving together the strands of science, history, politics and idealism – who can convey his passion and sense of urgency about our future survival. Pearson writes,

> Only a passion that takes into consideration the welfare of those yet to be born is justifiable in moral terms. It is the welfare of the entire phylogenetic continuum, not that of the individual alone, that should shape our passions and our morality.

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He lists some of the main genetically determined criteria for the type most able to carry civilization: intelligence; the ability to direct one's actions toward achieving long term goals instead of "instant gratification"; general physical health; properly directed altruistic behavior; and the capacity to learn from accumulated culture. He stresses that evolution cannot occur unless 'favorable' genes are segregated from 'unfavorable' ones.

Science has entered upon a new phase in the study of genetics, one which has wholly positive implications for the possible future of mankind – provided political forces do not prevent the utilization of this knowledge, and that contemporary dysgenic processes do not deprive future generations of an adequate proportion of those very genes which make that possibility a reality.

Genetics and the Future of Humankind

Future generations will look with amazement on the absurd notions that have distorted the thinking of Westerners in the 20th century. Equality of ability can never be a biological reality, except between identical twins. Some individuals obviously possess mental and physical qualities that enable them to be more creative, more productive, more healthy than others – even when the cultural or environmental playing field is level. If this were not the case, says Pearson, there could have been no possibility of evolution, and he quotes several scientific authorities who have warned about the slowing down of evolution in the modern world.

Steven Jones, a geneticist at University College, London (in *The Language of Genes: Solving the Mysteries of our Genetic Past, Present & Future*, 1994) is quoted as warning that "Natural selection has to some extent been repealed [with modern societies seeming "to conspire to slow down human evolution." Under natural selection the fit tended to survive to produce offspring while the unfit failed to leave the same number of progeny. But modern social conditions have reversed that situation.

William K. Stevens, in an article in the *New York Times* entitled "Evolution of humans may at last be faltering" (1994), is cited as observing that:

> ...rapid evolution occurred during the Pleistocene period (3 million years ago), and this was facilitated by the isolation of relatively small groups in disparate geographical environments. However, the

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> barriers which formerly enabled selected populations to evolve rapidly under severe selective pressures, and then spread outward to replace less advanced subspecies, have now been removed by modern technology and the vastly increased size of the overall hominid population. As a result, a melding of populations is creating a global gene pool, which in itself reduces the chances of further evolutionary selection – quite apart from the averaging down of intelligence, as the more intelligent either interbreed with the less intelligent or are outbred by the latter. The belief that humankind could benefit from being levelled into a single subspecies flouts the laws of evolution, since evolution is rooted in differentiation.

Timothy H Goldsmith, a professor of biology at Yale University, is quoted as warning, in his *The Biological Roots of Human Nature: Forging Links between Evolution and Behavior* (1991), that:

> ...the concept of morality's producing the greatest good for the greatest number is consistent only when the interests of the individuals are very similar. This has probably frequently been the case with small homogeneous groups in competition with other groups; it is less obviously so when groups are large and heterogeneous.

Ian Tattersall (a paleoanthropologist at the American Museum of Natural History), we learn from Pearson's work, has also warned that:

> ... *Homo sapiens* today is in a mode of intermixing rather than of differentiation, and the conditions for significant evolutionary change simply don't exist – and won't, short of some all-too-imaginable calamity.

Multi-cultural societies seldom live up to the dreams of integrationists. Stresses follow naturally, despite the best efforts to promote harmonious race relations. For example, in Brazil, where the human population comprises persons of American Indian, African and European origin, race-mixing is far advanced among the masses, but the more intelligent individuals of relatively unmixed European descent have segregated themselves from the less intelligent, resulting in extremes of wealth and poverty which tend to follow traditional lines

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of racial demarcation.

Rational Altruism

A call is made by Pearson for rational altruism, extending beyond the present generation to improve the genetic endowment and:

> ...to embrace as its goal the well-being of all those untold generations yet to be born, or which could yet be born provided humankind does not wreck the biosphere or destroy the finest elements of its genetic heritage produced by some three billion years of natural selection ... We can do not greater good than to leave the multitude of future generations a healthy genetic inheritance in a healthy and unspoiled environment. If we care for the future of humankind then we must breed preferentially from those most likely to bear offspring capable of lifting humankind to greater heights, not from those who would drag it downwards, back into the murky past ... Rational altruism requires each generation to avoid harming both the biosphere *and* the biological heritage...
>
> If the world does not collapse beneath the triple pressures of pollution, overpopulation, and severe dysgenic trends, and if governmental policies could be modified to take into consideration the findings of a scientific community encouraged to conduct human behavioral genetics research uncensored by radical Luddite ideologies, it is possible that the human race might still have a future worth working for.

To answer the question as to whether eugenic policies will be accepted, the author asks a counter-question: Will current ethical systems adjust to the truth as the genetic basis of disparities in individual and group genetic abilities becomes more widely appreciated? How far will the prevailing sociopolitical systems be prepared to modify their existing ethico-cultural goals.

But whatever political decisions are made in the short term, he suggests, in the long term dysfunctional ethico-cultural systems are doomed to extinction, simply because if they persist they will doom the biological communities which are guided by them. There is one all-powerful governing law in the universe: that which does not survive ceases to exist. A population which rejects biological reality – and encourages genetically handicapped or rival breeding populations to reproduce while reducing its own, healthy birth rate – is unlikely to

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have much of a future.

On the other hand, societies motivated by a higher altruism, embracing posterity, will choose to encourage eugenic and discourage dysgenic reproduction. If true altruism prevails, the result will be eugenic decisions, made voluntarily and without coercion. A degradation of the genetic constituency of a population is not easily reversed. The fate of humankind requires that we recognize that humanity and human behavior is not exempt from the laws of causality, and that human ethical systems should be attuned to the fact that culture rests on a biological basis. Having freed itself in the short term from natural selection, and indeed having – at least for the present time – replaced essentially benevolent natural selection by strongly dysgenic unnatural selection, humanity may well be currently involved in a process of culturally-determined biological devolution. We are living in a uniquely significant period of time, in which the positive achievements of thousands of years of natural selection could well be reversed. That is the sobering message contained in this highly informative and heavily-documented work.

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BOOK REVIEWS

Security Market Imperfections in Worldwide Equity Markets
Donald Bruce Keim and William T. Ziemba, Editors
Cambridge: Cambridge University Press, 2000

Comprising a collection of papers on stock prices in different part of the world, originally given at the University of Cambridge, this book will be valuable to finance professors interested in the numerous cases where standard efficient market theory does not fit the data. However, it will also be valuable to investors. For those shopping for most goods an imperfection is something wrong. However, for a portfolio manager or an individual investor, an "imperfection" in the sense of this book is a way to predict stock market returns. Thus this book can be extremely valuable to investors in pointing to profitable strategies, even though it is not marketed as a practical investment book.

The first set of papers deals with cross-sectional regularities in stock market returns. For investors this is the question of what types of stocks have historically yielded the highest returns. Variables such as a small market capitalization (price multiplied by number of shares), a high book value to price ratio, a high earnings yield, and price momentum are typically found to give highest returns. Hawawini and Keim here show that much of the high return from these factors has come only during the month of January. They argue this goes against interpreting these high returns as merely returns to risk.

Several of the papers deal with the small firm effect. The small firm effect is the tendency over a long period of time for the smaller capitalization stocks to have had higher returns than the large capitalization stocks. Although this small capitalization effect has existed since at least 1926 for the US, Dimson and Marsh show that the effect disappeared and reversed about the time when investors in the US and in the UK became aware of it.

DeBondt summarizes the evidence that contrarian strategies work. He shows that for the US (1926-1982), buying the 50 stocks that have done worse over the last five years beats the indices, while buying the 50 stocks that have had the best performance over the last five years under-performs the indices. He cites studies in 10 countries showing that the success of such contrarian strategies is worldwide. Studies on

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the relative performance of value and growth strategies (such as buying high book to market value stocks, high earning or cash flow to price stocks, high dividend yielding stocks) covering thirteen countries show that value strategies outperform growth strategies. He describes his study using US analysts' forecasts of earnings growth where buying the 20% of firms about which analysts were most pessimistic, and short selling the 20% about which they were the most optimistic earned substantial profits. The profits were greatest for the longest forecast horizon.

Another major theme of the book deals with seasonal effects. The most discussed of these is the January effect, by which stocks usually show the highest returns in the month of January. This is especially strong for the lower capitalization companies.

Hensel and Ziemba's timely paper looks at the periods following presidential elections. They again document a tendency for the market to do better in the two years before presidential elections than in the two years following them. This is usually attributed to politicians' taking actions to produce prosperity, and higher stock markets, before elections. In a new finding, Hensel and Ziemba show that small stocks have done best in the years when the president was a Democrat, and that a strategy of being in small stocks in Democratic years, and in large stocks or bonds in Republican years would have outperformed an all-stock strategy.

Hensel, Sick, and Ziemba conducted a long-term examination of the turn-of-the month effect in the S & P 500. The turn-of-the month effect refers to a tendency for stock returns to be abnormally high around the turn of the month. This has been attributed to payments such as salaries, dividends, and pension contributions coming either at the end or the first of a month and being invested soon afterwards, producing an inflow of funds that bids stock prices up. These researchers report significantly high stock returns for the first half of the month compared to the second half. A detailed plot of the Standard and Poor index returns by day of the month from January 1928 to June 1993 shows a stretch of above-average returns from two days before the end of the month to three days afterwards (with the fourth day being average). All of the other days (except for day 7) were below-average. This suggests a trading strategy of being in the market around the turn of the month would have been profitable. Those with retirement accounts that permitted moving between different funds could have implemented such a strategy without commissions or tax

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penalties.

While many chapters deal with non-US markets, the last major section deals with the international evidence on security market imperfections. There are a series of specific chapters dealing with individual countries, including Canada, Italy, Turkey, Finland, and Japan (two chapters). An especially valuable chapter covers the Asian emerging markets (Koh and Wong). These chapters will be useful to those concerned with the markets covered.

Of particular interest is the last chapter in the book that deals with the high stock returns before holidays (by Cerven, Alonso and Keim). Previous research had documented that the day before US holidays had unusually high returns. This chapter extends the finding to a large number of holidays in a multitude of countries.

For the investor in a retirement fund or mutual fund group that permits moving money from account to account as many do, the finding about pre-holiday returns, returns at certain times of the month, or on certain days of the week, or in January could assist him in increasing his returns. Such an investor might choose to be in stocks at the calendar times when they were most likely to go up and in bonds or Treasury bills at other times.

One problem in this collection of valuable papers is lack of index. Someone cannot look up a topic in an index and be directed to the discussions of this in the various chapters.

Edward M. Miller
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Monopoly Politics
James C. Miller
Hoover Institution Press, Stanford CA. 1999

James Miller's new book examines the possible application of public choice theory to politics. Drawing on his academic background in economics and his personal experiences in political affairs, Miller compares political with economic competition, asking how political competition can be made more effective.

The prime topic is therefore essentially "political markets," and the author organizes his study into seven major chapters. The first documents the importance of public decisions and distinguishes public from private decision-making. The second and third discuss the nature of competition in commercial and political markets in terms of

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individual sovereignty, incentive to monopolize, and antitrust laws. The fourth and fifth chapters specially deal with the remarkable features of political markets, the advantages of an incumbent, and the major institutional restraints on competition in political markets. The last two chapters concentrate on policy reforms and recommendations for the future.

As a political economist, Miller focuses on the differences between personal (commercial) choices and public (political) choices. Both choices affect our being. Miller discusses the political institutions within which people make economic decisions, including property rights and contracts.

Quoting from Adam Smith's (1776) *An Inquiry into the Nature and Causes of Wealth of Nations*, Miller points out that consumers are the king or boss in the commercial market, which gives them a wider range of sovereignty in their decision-making process and the market forces drive consumers and producers. However producers have an incentive to become a monopolist, and consumers have an incentive to be monopsonist. In real world public concern is directed to monopoly power on the selling side as pointed by Miller. To limit monopoly power a series of "antitrust laws" has evolved over the past decades. Miller explains the limitations and imperfections of antitrust laws in the commercial markets.

As a professor of economics, Miller brings back the economic ideas and rationale of competition and monopoly in political markets. In most political markets voters choose the electoral officials to represent them. Miller points out how political parties or candidates have incentives to collude with political rivals in order to exclude competitors and to avoid mutually damaging rivalry. To combat the monopolization of political markets and preserve competitions among political parties, election laws indirectly serve the same function as antitrust laws. Miller uses the distribution of voter preferences to discuss how parties and candidates will position themselves.

The economic theory of politics assumes that voters are utility maximizers and that political parties are vote maximizers. Politicians are motivated by self-interest and formulate policies accordingly. This view conflicts with the social welfare-maximizing model of government behavior in which politicians seek office to expedite pre-conceived policies designed for the social good. There is one logical problem with the model of voters voting for their own well being, and candidates trying to promote the policies that maximize their chances of election.

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Because the typical voter in an election has very little chance of determining the outcome, the voter's increase in utility from voting is likely to be very low, too low to induce a selfish voter to vote. However, when the total benefit from having the right candidate elected is multiplied by the small probability of a single vote changing the outcome of an election, it is rational for a voter to vote for altruistic reasons. Of course, what the voter thinks is good for the community may be influenced subconsciously by what is good for him and his family.

It follows that the model of the rational but selfish voter has a logical inconsistency. Alas, this argument is not made in the book.

Other differences between commercial markets and political markets include information asymmetries, principal-agent problems, political speech, constitutional restrictions etc. Miller himself argues against the efficiency of political markets both theoretically and empirically. Selected data for the US Congress suggests that the assets of office provide a substantial advantage to incumbents. This is a major impediment to the competitiveness of political markets. In fact, Miller argues the rules limiting spending usually benefit the incumbent much more than the challenger.

The rules of economics differ from the laws of physics in that economic rules are subject to socio-institutional conditions. Miller proposes institutional reforms for Congress. He suggests that campaign-finance laws should be revised to make political markets more competitive. However, he points out how many proposed "reforms" would make political markets less competitive. Incumbency gives a major advantage to whoever is already in office, and if the challengers are to have a chance they must be able to raise enough money to become known.

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Edward M. MIller
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The Inevitable Dominion by Man: An Evolutionary Detective Story
Seymour W. Itzkoff
Paideia Publishers, Ashfield, MA. 2000

Seymour Itzkoff has authored a number of important books on

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the subject of human evolution, but his latest is perhaps his most comprehensive exposition on the subject. It makes excellent reading for those laymen who wish to obtain a comprehensive overview of animal evolution and particularly of what happened in human prehistory. Indeed, it will prove particularly helpful for those who are bewildered by the Out-of-Africa debate.

The Inevitable Dominion by Man sets forth a evolutionary model for the coming of highly intelligent humans which begins with the early sexually reproducing eukaryote cell, originating at least 1.5 - 2 billion years ago. It argues that the existence of an evolutionary environment of instability and change propelled a variety of ever more intelligent creatures into a positive adaptive and selective stance with nature. As such, Itzkoff argues that a highly intelligent creature dominating the Earth's surface was inevitable given the perdurance of our bio-chemical environment. He favors a traditional neo-Darwinian process of gradual evolutionary change in which the ancestors of humans long differentiated themselves from other mammal and primate lines, contra humans as "third chimpanzees". Cytogenetic evidence (pp. 128-131) harmonizes with recent DNA analysis to indicate only 30,000 genes in man, rather than 100,000 as formerly believed, as compared with the 15,000-20,000 genes in some primitive but specialized worms. The line of vertebrates leading to humans clearly separated and matured at an earlier stage in evolution than has hitherto been supposed. The strength of the argument that high intelligence and truly modern humans arose in the north far beyond what existed in the tropical zone of primate life is strongly buttressed by the wider evolutionary model developed in this book.

Because of the heavy political overtones associated with anything that explains the origins and diversity of the living peoples of the world, popular discussion of the Out-of-Africa argument has been conducted in a somewhat veiled manner. Polemicists have tried to contend that because man's primate ancestors must clearly have evolved in tropical climates, there is an extremely close biological link between those races whose more recent history has been in temperate climates and those that have remained more closely adapted to tropical environments. The fact that a major genetic division separates populations of Caucasoid and Mongoloid characteristics from those of sub-Saharan or Negroid character is seldom mentioned outside of academe. Most popular, and even some academic, expositions of the Out-of-Africa theory claim that "modern" man evolved in Africa, and that little evolutionary change of

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significance occurred amongst human populations outside of Africa. That argument does not reflect the scientific evidence, and Itzkoff makes this clear in his easy-to-read but nevertheless up-to-date and scholarly exposition.

Much of the confusion over the African Eve concept arises from the loose use of the term "modern humans." Indeed, there is much terminological confusion in scholarly writings and vast terminological confusion in popularizing and polemical works. Itzkoff avoids this by arguing with justification that the first truly "modern" humans known to paleolontologists were the Cro-Magnons, who might quite reasonably be seen as the ancestors of modern Europeans. But the Cro-Magnons extended beyond the borders of Europe, and their descendants spread out in successive waves of migration across Asia, and even back into Africa. There is still sound reason to argue that in these areas of colonization they may have admixed with older populations, and so created the vast array of diverse peoples or races that the world knows today.

Of course, this theory runs contrary to the scenario proposed by the African Eve, Out-of-Africa proponents. They see "modern man" as having attained modernity on the African continent, and then migrated from thence around the rest of the world, replacing, without interbreeding with, the more primitive *Homo erectus* and Neanderthaloid species that were already occupying much of Asia and Australasia in a truly vast, racialist genocide. But Itzkoff discusses the evidence dispassionately and competently. The idea that Africa was most probably the original homeland of our earliest forebears is not questioned, but there can be no doubt that Cro-Magnons, Caucasoids and Mongoloids attained their present characteristics in the much colder Eurasian region, and he believes that there is little question that Cro-Magnons or their descendants migrated eastward to intermingle with older Asian populations there to give us the modern Mongoloid-type populations of China, Korea and Japan. Thus he writes:

> The first Chinese dynasty, the Shang, is traditionally characterized by the Chinese themselves as governed by a red-haired, green-eyed people, possibly of Persian origin (much like characterizations of the original Mongol leadership, at 1200 A.D), who arrived on horse in the Yellow River Valley, at about 2,000 B.C. Shortly after, literacy was developed, the Chinese civilization thence taking its own uniquely developed Oriental route. Early dynastic iconography

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in China hints at the Caucasoid roots of this aristocracy, gradually to be largely effaced by a dominant modern Mongoloid phenotype.

Surprisingly, Itzkoff does not mention the problem of the origin of the Asian Negritoes, though there is a substantial likelihood that these may be descended from an early migration by African Negroid elements across southern, tropical Asia, never moving into the colder northern hinterland, and so retaining their tropical Negroid adaptations.

Itzkoff properly places emphasis on the extent to which learned patterns of behavior have allowed man to frequently suppress or modify the direct expression of his genetically-determined, innate drives and propensities, in contrast to the behavior of other animals. It is interesting, however, that he occasionally speaks of human "freewill" without attempting to define or analyze this popular concept. In the popular mind, freewill is something that allows mankind to act contrary to the principles of scientific causality. It may be that the complexity of the mechanism of human behavior is such that what we call "freewill" is merely the obscure workings of genetically determined impulses intertwined with learned behavior in such complexity that it denies attempts to explain it in causal terms. Regardless of such fine points, however, Itzkoff is quite right in stressing the role of what we conveniently call human "freewill," although we suspect the validity of the popular understanding of freewill as something above and outside causality.

One other aspect of interest in Itzkoff's intriguing study relates directly to the title of the book. Mankind has come, inevitably, to dominate our planet and all forms of advanced plant and animal life on the planet. This could well lead to ecological disaster, since man's emotive drives, shaped as they are for survival under primitive conditions, have not yet responded to any rational warnings provided by his intellect. Man's primitive drive toward procreation, combined with the technological supremacy he has achieved over all competing life forms, threatens the environment on which all higher life forms depend. Whether or not man will irreparably damage the balance of the biosphere on which all higher life forms depend, including his own species, is a question which too few, even amongst the more advanced populations of today's world, are prepared to face. This is one of the more important topics touched on in Itzkoff's study, as directly implied by the title, and the present writer only wishes that Itzkoff had laid slightly more emphasis upon this threat. But so far as a concise

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exposition of what we know about human origins is concerned, this book stands out far ahead most other recently published works.

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Dear Enemy: Germany Then and Now
James Bacque and *Richard Matthias Müller*
Fenn Publishing Company Ltd, 2000

It is rare in life, and just as rare in books: a sustained conversation – articulate, sensitive, insightful, adult, caring, and carried on with never-failing courtesy, affection and mutual respect. Such a conversation as the one here, conducted in correspondence over a four-year period and reduced to letters that occupy not quite 200 pages, offers the reader one of life's truly luminescent moments, not unlike hearing Tchaikovsky's Fifth Symphony or Bruchs' Violin Concerto for the first time. I know of no book that matches *Dear Enemy* as an exchange of pure intelligence, delightfully expressed.

To the qualities just mentioned must be added those of honesty and good will. It may be that intellectual honesty is a rare alpine flower during any period of history; but in our "politically correct" time, during which an intellectual incubus lies so heavily over us, it is rarer still. That perhaps more than anything else is what makes this book so compelling.

James Bacque is a Canadian scholar who very much believed in the Allied cause in World War II, which was being waged just as he grew out of his infancy. Even now, many years later, he says, "I want, I desperately need, our Victory to mean and to have meant something. What? To save Europe, I suppose, to bring to life democracy, freedom, civility, truth...." Certainly it was this passionate conviction that moved millions on the Allied side. His inquiries led him, however, to a ghastly discovery: that those ideals had been mocked and shamed by Allied conduct during and after the war. Curtained off from reality by heavy layers of silence, few people in the United States and the other allied countries know of the atrocities committed in their name. Not as an expression of alienation against a civilization whose best ideals he embraces, but as an honest man's reaffirmation of those ideals, Bacque wound up writing *Other Losses* about the death of 700,000 German

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prisoners of war while they were in American hands, and *Crimes and Mercies* (reviewed in the spring 2000 issue of this journal) about the fate of German civilians under Allied occupation between 1944 and 1950.

Richard Matthias Müller brings equal idealism and intelligence to the conversation, but from across a great divide. A slightly older man than Bacque, he had been old enough to belong to the Hitler Youth and then to have been a Nazi and a soldier in the Wehrmacht. At the end of World War II, he was one of the prisoners in the American camp at Remagen, which is one of the camps that Bacque wrote about and where Müller was almost starved to death. Since the war, he too has been a scholar, and is author of *On Germany* (1965) and *Normal-Null* (in which he expresses a theory of moral expectation). His perspective is by no means pro-Nazi, but he does lend some insight into the thoughts and feelings of Germans before and during the war.

The two men met through a friend in 1991 and began a correspondence, "opening vast and verboten topics" that reflected their very different perspectives. It wasn't long before they saw that the correspondence was so substantive that it should be made into a book.

Needless to say, the very occurrence of a humane correspondence between these two former enemies, who once hated each other as their societies fought each other to the death, has at its heart a premise that is bound to receive increasing acceptance as more and more time passes, but that today, even 55 years after the end of the war, is "far ahead of the curve" so far as many people's sensibilities are concerned. A civil conversation between a Canadian and a former member of the Hitler Youth?! One in which they both seek truth and a sound assessment?! Impossible! To those who think that everyone who fought on Germany's behalf in World War II must have been congenitally bestial, this book of correspondence will challenge some long-cherished assumptions. It is precisely those who feel most strongly that way who should most assuredly read it. Eventually, the world will see that conflict, as all others, as a struggle among human beings. The caricatures will fall away. When they do, there will be much to learn, and a good place to start will be by rereading this book's conversation between the two former enemies.

The conversation between them is at times almost Dostoevskian, although without ever being heavy. It is preoccupied with questions of responsibility, guilt, atonement, forgiveness and reconciliation, speaking a moral language full of insight and poetry that is not often

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encountered amid today's secular preoccupations. It especially focuses on postwar Germany's decades-long culture of guilt, mulling over its psychology, its genuineness, and its mythology, although Bacque's discoveries and Müller's personal experience interject elements of Allied guilt, too, giving an added dimension to what is already a very subtle comprehension.

If the discussion were even mainly quasi-mystical, however, it wouldn't long retain interest. Instead, the letters range over a vast array of related subjects, as friends corresponding with each other are apt to do. They include such things as the resistance movement against Hitler; the *Historikerstreit* of the mid-1980s that saw German historians, particularly Ernst Nolte and Jurgen Habermas, quarreling among themselves about the respective natures of Nazism and Communism; the post-war German constitutional provision admitting all asylum-seekers, leading to potentially limitless immigration; and whether the United States would have been willing to drop atomic bombs on German cities if the war had lasted long enough. A couple of the letters provide what is in effect a review of Daniel Goldhagen's book *Hitler's Willing Executioners*, which asserts that Germans had long held to a unique form of "eliminationist" antisemitism.

Bacque and Müller have pierced many of the shibboleths of today's ideological incubus, but others remain to be explored, and we can only hope that each has several more years in which to do so. We can be sure that if they do the results of their examination will be equally honest, whether the outcome of that reflection agrees with our own on any given point or not. I have my doubts about Bacque's acceptance of the conventional wisdom about Whites' centuries-long displacement of the American Indians, about Hiroshima and Nagasaki, and about his criticism of Reagan's "Evil Empire" characterization of the Soviet Union as being yet another example of Americans' (very real) propensity to demonize their opponents. With a mind as alive as Bacque's, though, the process of intellectual discovery never ends. And that is the key to the compelling readability of the Bacque-Müller correspondence.

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Knights of the Brush:
The Hudson River School and the Moral Landscape
by James F. Cooper
Hudson Hills Press, 1999

Readers of this journal will recall the article entitled *An Artistic Renaissance?* in the summer 1999 issue that told of the *American Arts Quarterly*'s championing of a potential aesthetic renewal in the United States. The goal of the Newington-Cropsey Foundation, publisher of the Quarterly, has been to promote sublimity and beauty in the arts, supplanting what it sees as a studied ugliness in postmodernist art. One of the early-American schools of art that is often featured within the Quarterly is the Hudson River School of Romantic painters that towered over American painting between 1830 and 1860. Although the Quarterly contains articles by a number of authors about many different artists and their work, the intellectual core of the Quarterly's efforts comes from two men: James F. Cooper, the editor, and Frederick Turner, who works with the magazine and serves on the editorial advisory board.

Now the Quarterly is in effect supplemented by a book of high-quality artistic reproductions and aesthetic, historical commentary. James F. Cooper is *Knights of the Brush*'s primary author, providing the text that accompanies the illustrations and that explains the characteristics of the Hudson River School and its place in American history. Frederick Turner adds a second to Cooper's views with a brief Foreword. Fifty-six colorplate reproductions of the leading paintings by such artists as Thomas Cole, Jasper F. Cropsey, Frederic Edwin Church, Asher Brown Durand, and others, combine with the text to make this book rank high among the many beautiful and informative art books available.

The early nineteenth century American wilderness, suffused with light that is made even more striking by its contrast with deep shadow, provides the paintings' subject. The scenes often contain Protestant Christian imagery, reflecting the artists' central purpose of presenting nature as a manifestation of God's presence. The values informing their work? – virtue, chivalry, spirituality, beauty, order – to which we might add Plato's philosophic Realism, as is evident when reference is made to "timeless archetypal forms."

Accordingly, Cooper and Turner see the Hudson River School as a champion of artistic standards that have been repudiated by the

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postmodernist school, which for several years has held sway within academic and institutional art. They tell us how art today has been politicized and condemns the past as Eurocentric, heterosexual, racist, hierarchical, and an instrument of class and racial oppression. The radical relativism of Foucault and Derrida denies the value of standards, representational art, and archetypes.

To present this contrast and to point, then, to a possible renewal of Western artistic commitment to beauty, *Knights of the Brush* contains three sections: "Paradise Found," about the Hudson River School itself; "Paradise Lost," about the slide into secularism and cultural alienation; and "Paradise Regained," about the signs of incipient renewal.

There is more that could be told here about the paintings and artists themselves, but the reader is best left to experience those things personally, since the paintings speak more eloquently than words can describe.

In some important ways, this reviewer would suggest, however, a different analysis of recent art history than the text provides:

It is a mistake, induced by focusing exclusively on art as it is recognized by an "art establishment," to believe that contemporary American art repudiates the beauty-focused art of the past. This repudiation comes from an institutionally dominant art, but there is a vast corpus of art, much of it excellent, being produced by thousands of artists throughout the country that has always continued to be representational and "traditional." The renaissance for which the Newington-Cropsey foundation hopes has, in effect, always been there, if only the non-establishment art were given full recognition.

Perhaps this reviewer's main conceptual criticism of the text's analysis is that it is only partly correct in ascribing the 20th century's move into alienated art to the rise of secularism. It is indisputable, of course, that secularism has taken the West away from the Hudson River School's vision that "God is immanent in nature." But the Enlightenment and secularism need not have given rise to alienated art, one that is actually (as one Dadaist described it) "anti-art."

It is important to understand the central feature of what we know as "the world Left" as it came into being in the early 19th century. Perhaps the best definition of "the Left" is that it has for almost two centuries been a movement headed by a vastly influential literary-artistic subculture that has fashioned its thinking to appeal to the many allies it has sought, with varying degrees of success, to enlist from disaffected or unassimilated groups. Marx courted the "proletariat," but

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that was just one of many hoped-for sources of support. The most characteristic feature of the alliance has been its alienation against virtually all aspects of 19th and 20th century mainstream Western society.

This combination of alienation and alliance-with-disaffected-groups produced an ideology (which may be spoken of in the singular even though it has experienced many intramural disputes) that, as one of its principal weapons, has included a repudiation of the value-system embraced by the mainstream society – and this has included a repudiation of what the subculture has seen as "bourgeois" art. If we understand this dynamic, we see that it has been the Left, not secularism or the Enlightenment *per se*, that has so long been the inveterate enemy of sublime or even emotionally satisfying art. It is possible to be secular without being alienated.

To this, of course, a caveat must be added. It is that the Left has in quite a serious way been mistaken in its identification of representational and beauty-oriented art with the mainstream modern commercial and middle class culture; it is true that the average person prefers that sort of art, but such art was revered long before the rise of such a society (and, seen historically, has largely been a product of aristocracy). In its alienation, the Left has thrown out the Athenians with the Philistines.

This criticism of Cooper's analysis is the same as this reviewer has made previously of the historical perspective of Russell Kirk, who in common with Richard Weaver and others saw modern secularism as the central force for cultural destruction. Cooper's text seems very much a reflection of Kirk. The criticism is included here not to diminish *Knights of the Brush*, but intellectually to give its message the attention it deserves.

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